Proxy

Notice of Annual Meeting of Shareholders

Proxy Statement

and

1996 Annual Report

COVER PRINTED ON RECYCLED PAPER

To Our Fellow Shareholders:

The strong performance of The Kroger Co. in Fiscal Year 1996 was highlighted by:

- the fourth consecutive year of improved sales, cash flow, and earnings;
- continuation of the largest store construction program in the Company's history;
- completion of consolidated distribution center projects to achieve economies of scale;
- substantial progress in cost reduction.

These achievements, the result of dedicated efforts by 212,000 Kroger associates, helped generate a 24% increase in the price of Kroger's stock during 1996.

1996 in Review

Earnings before a charge for early debt retirement were $352.7 million, compared to $318.9 million in 1995. Fully diluted earnings per share rose from $2.50 to $2.67 on the same basis. After the debt retirement charge, Kroger's net earnings were $349.8 million, or $2.65 per share. Operating cash flow increased 6.7% to $1.241 billion.

Sales in 1996 reached $25.2 billion, a 5.2% increase over 1995. Comparable store sales, which include sales from expanded and relocated stores, increased 4% while identical food store sales rose 1% excluding the effects of strikes at two divisions.

Capital expenditures totaled $734 million in 1996, about even with the previous year. In addition, Kroger completed $72 million in sale and leaseback transactions for supermarkets. During the Fiscal Year, our Company opened, expanded or relocated 116 stores, which increased total food store square footage by 6.7%. At the end of 1996, Kroger operated 1,356 food stores under seven names in 24 states and 831 convenience stores under six banners. Retail operations are supported by 36 manufacturing plants which produce Kroger-label products as well as items for other food manufacturing and retail clients.

During the past four years, Kroger has invested approximately $232 million in technology and logistics projects. The financial return on these investments is very attractive and the new systems provide a competitive advantage. These systems have improved customer service while reducing product, distribution, and operating costs.

Financial Review and Debt Reduction

Strong operating cash flow and careful working capital management strengthened Kroger's financial structure in 1996. The Company redeemed the $125 million outstanding balance of 9% Senior Subordinated Notes and issued $240 million of 8.15% Senior Notes. Net interest expense for the year declined to just under $300 million from $312.7 million.

As of early 1997, both Fitch Investors Service, L.P. and Moody's Investors Service upgraded the Company's debt to "investment grade," citing Kroger's consistent financial performance. This upgrade is a major achievement for our Company and a positive development for shareholders. It expands the base of potential investors, reduces interest costs on future borrowings, and improves Kroger's access to capital.

Operating Strategy, 1997-1999

Kroger's objective is to generate a minimum 13-15% annualized increase in earnings per share over the next three years. This goal is challenging, but achievable. In order to reach it, the Company will remain focused on strategies to generate sales and earnings growth from:

—construction of new square footage;
—generation of higher returns from existing assets; and
—enhancement of technology and logistics systems.

• *New Square Footage.* Over the next three years, Kroger will invest approximately $800-$850 million annually to complete 100 store projects each year. This growth will increase retail square footage by about 5-6% per year.

As in the recent past, we will concentrate our storing program in existing markets. Kroger enjoys the number one or two share in virtually every major and secondary market we serve. Our capital investment strategy is designed to build on this strength and take advantage of distribution, administrative, and advertising efficiencies.

Kroger will continue to consider selective acquisitions that complement our operating territories. In early 1997, we acquired 10 stores from Harvest Foods, Inc. in Arkansas. These new locations augment Kroger's strong presence in the Little Rock metropolitan area and bring our stores to several contiguous areas.

• *Higher returns from existing assets.* Kroger's combination food and drug store is the powerful format that drives our business. Our division and store managers are experts at operating these facilities in a manner that offers exciting product variety and merchandising approaches, one-stop shopping convenience, and outstanding customer service in a cost effective manner.

The stores are in excellent physical condition. Within the past five years, half have been constructed, expanded, or remodeled. They are equipped with modern technology and information systems, such as in-store processors and a satellite network, that enhance efficiency and enable our associates to focus on serving customer needs. We are now implementing a new generation of technologies that will further enhance store productivity. These include improved check authorization systems, electronic shelf price audits, electronic funds transfer, and electronic pharmacy claims adjudication.

In 1995-96, Kroger invested approximately $70 million in logistics projects designed to streamline our distribution network and reduce costs of transportation and storage. A substantial portion of this investment was earmarked to expand three existing consolidation centers and to build a fourth center for the distribution of slow-moving grocery and health and beauty care items. In addition, the Company is consolidating small satellite warehouses for grocery and perishable products to reduce distribution costs.

For many years, Kroger has centrally procured produce, health and beauty care items, and meat and deli products. Most grocery items have been purchased by individual marketing areas. In early 1997, Kroger began to achieve additional buying efficiencies by coordinating certain grocery purchases across marketing areas. Kroger can now take advantage of its $25 billion sales volume to negotiate national promotions that will reduce product costs.

• *Technology and logistics enhancements.* Kroger's investment in technology and logistics surpassed $72 million in 1996. Some of the projects underway include:

<u>Warehouse information management system (WIMS):</u> a computerized real time program that enables our distribution centers to reduce inventory levels while improving the accuracy of purchase orders and invoices. WIMS is currently under test in two distribution centers.

<u>Computer assisted ordering (CAO):</u> a promising technology which matches product shipments to actual sales volumes, thus reducing inventory and improving each store's ability to manage precious shelf space. More than 350 stores are currently using CAO.

<u>Paperless environment:</u> the replacement of paper by electronic data wherever economical. In cooperation with major suppliers, Kroger is eliminating paper invoices and purchase orders through electronic data interchange (EDI). The goal is to eliminate paper transactions. We are also using electronic data transmission in a variety of internal programs.

Labor Relations

Kroger experienced a positive labor relations environment in 1996, except for strikes in our King Soopers and City Markets divisions. Overall, the Company continued to make progress by successfully negotiating more than 60 collective bargaining agreements. Several of these are extended 4-5 year contracts.

Community Activities

Throughout 1996, Kroger's community relations activities enhanced the Company's corporate reputation among customers, associates, civic and charitable organizations, and public officials. The Kroger Co. Foundation contributed $2.9 million to a wide variety of community projects. Cash contributions from operating earnings totaled $5.5 million. In addition, the Company donated more than $5.5 million of products —much of which served communities affected by emergency or disaster relief situations.

Thousands of Kroger associates were enthusiastic volunteer participants in a number of community-wide charitable events. For example, Kroger employees raised just over $1 million during 1996 for the March of Dimes, which represented the third highest total collected by any company in the United States.

The favorable publicity generated by these activities strengthened Kroger's community reputation for customer service. In April, the Cincinnati-Dayton division was honored as "Employer of the Year" by Arc, an agency that supports people with mental retardation. The award was prompted in part by complimentary letters from Kroger shoppers who had been served by store associates with physical or mental disabilities.

The Year Ahead

Kroger management is confident that the Company's strategy will continue to generate solid growth and increasing value for shareholders. The execution of our business strategy is founded upon the support and talents of Kroger's 212,000 associates. Their exceptional service to customers and communities is the source of Kroger's strong performance. We extend our sincere thanks for their commitment.

In March 1997 the Company announced a 2-for-1 stock split on its common stock, effective as of the close of business on April 4, 1997. The decision to split the stock reflects the Board of Directors' confidence in the long term performance and strength of the Company and is a compliment to the sustained commitment of Kroger's dedicated associates.

Director and Executive Changes

Edward M. Liddy, President and Chief Operating Officer of the Allstate Corporation, was elected to the Board of Directors.

Warren F. Bryant, President of Dillon Companies, Inc., was elected to the additional position of Chief Executive Officer of Dillon. Donald E. Becker, Vice President—Merchandising, Cincinnati-Dayton Marketing Area, was promoted to President, Central Marketing Area, replacing Theodore Engel, who retired after 39 years of distinguished service. Don W. McGeorge, President of the Michigan Marketing Area, was named President of the Columbus Marketing Area, succeeding William D. Parker, who retired after 40 years service with Kroger. McGeorge was replaced as President in Michigan by Bruce A. Lucia, who had been Executive Vice President of the division. Mark Salisbury was promoted to President of Tom Thumb Convenience Stores, and Henry R. Waguespack was named President of Kwik Shop, Inc. John Cox was named President of Jackson Ice Cream Co., Inc. Geoffrey J. Covert joined Kroger as Vice President, Grocery Products Group.

Joseph A. Pichler

JOSEPH A. PICHLER
Chairman and
Chief Executive Officer

David B. Dillon

DAVID B. DILLON
President and
Chief Operating Officer

Notice of Annual Meeting of Shareholders

Cincinnati, Ohio, April 4, 1997

To All Shareholders
of The Kroger Co.:

The annual meeting of shareholders of The Kroger Co. will be held at the OMNI NETHERLAND PLAZA, 35 WEST FIFTH STREET, Cincinnati, Ohio, on May 15, 1997, at 10 A.M., for the following purposes:

1. To elect five directors to serve until the annual meeting of shareholders in 2000 or until their successors have been elected and qualified;
2. To consider and act upon a proposal to approve the 1997 Long-Term Incentive Plan;
3. To consider and act upon a proposal to ratify the selection of auditors for the Company for the year 1997; and
4. To transact such other business as may properly be brought before the meeting; all as set forth in the Proxy Statement accompanying this Notice.

Holders of common shares of record at the close of business on March 18, 1997, will be entitled to vote at the meeting.

YOUR MANAGEMENT DESIRES TO HAVE A LARGE NUMBER OF SHAREHOLDERS REPRESENTED AT THE MEETING, IN PERSON OR BY PROXY. PLEASE SIGN AND DATE THE ENCLOSED PROXY AND MAIL IT AT ONCE IN THE ENCLOSED SELF-ADDRESSED ENVELOPE. NO POSTAGE IS REQUIRED IF MAILED WITHIN THE UNITED STATES.

By order of the Board of Directors,
Paul W. Heldman, Secretary

Proxy Statement

Cincinnati, Ohio, April 4, 1997

The accompanying proxy is solicited by the Board of Directors of The Kroger Co., and the cost of solicitation will be borne by the Company. The Company will reimburse banks, brokers, nominees, and other fiduciaries for postage and reasonable expenses incurred by them in forwarding the proxy material to their principals. The Company has retained Hill & Knowlton, Inc., 420 Lexington Avenue, New York, New York to assist in the solicitation of proxies and will pay that firm a fee estimated at present not to exceed $15,000. Proxies may be solicited personally, or by telephone, as well as by use of the mails.

Joseph A. Pichler, John T. LaMacchia, and T. Ballard Morton, Jr., all of whom are directors of the Company, have been named members of the Proxy Committee.

The principal executive offices of The Kroger Co. are located at 1014 Vine Street, Cincinnati, Ohio 45202-1100. Its telephone number is 513-762-4000. This Proxy Statement and Annual Report, and the accompanying proxy, were first sent or given to shareholders on April 4, 1997.

As of the close of business on March 18, 1997, the Company's outstanding voting securities consisted of 126,959,971 shares of common stock, the holders of which will be entitled to one vote per share at the annual meeting. The shares represented by each proxy will be voted unless the proxy is revoked before it is exercised. Revocation may be in writing to the Secretary of the Company or in person at the meeting or by appointment of a subsequent proxy. The laws of Ohio, under which the Company is organized, provide for cumulative voting for the election of directors. If notice in writing is given by any shareholder to the President, a Vice President, or the Secretary of the Company not less than 48 hours before the time fixed for holding the meeting that the shareholder intends to cumulate votes for the election of directors and, if an announcement of the giving of that notice is made by or on behalf of the shareholder or by the Chairman or Secretary upon the convening of the meeting, each shareholder will have the right to cumulate votes at the election.

If cumulative voting is in effect, a shareholder voting for the election of directors may cast a number of votes equal to five times the number of shares held on the record date for a single nominee or divide them among nominees in full votes in any manner. Any vote "FOR" the election of directors will constitute discretionary authority to the Proxy Committee to cumulate votes, as the Proxy Committee determines, if cumulative voting is requested.

The effect of broker non-votes and abstentions on matters presented for shareholder vote is as follows. The election of directors is, pursuant to Ohio law, determined by plurality; broker non-votes and abstentions, therefore, will have no effect on that proposal. The 1997 Long-Term Incentive Plan is to be approved by a majority of the shares represented at the meeting. Therefore, broker non-votes will have no effect and abstentions will have the effect of a vote against the proposal. Ratification by shareholders of the selection of auditors requires the affirmative vote of the majority of common shares represented. Accordingly, broker non-votes will have no effect and abstentions will have the effect of a vote against the proposal.

Proposals To Shareholders

Election Of Directors
(Item No. 1)

The Board of Directors, as now authorized, consists of 14 members divided into three classes. Prior to the annual meeting of shareholders, the Board of Directors expects to increase the authorized size of the Board to 15 members. Five directors are to be elected at the annual meeting to serve until the annual meeting in 2000 or until their successors have been elected by the shareholders, or by the Board of Directors pursuant to the Company's Regulations, and qualified. Candidates for director receiving the greatest number of votes cast by holders of shares entitled to vote at a meeting at which a quorum is present are elected, up to the maximum number of directors to be chosen at the meeting. The committee memberships stated below are those in effect as of the date hereof. It is intended that, except to the extent that authority is withheld, the accompanying proxy will be voted for the election of the following five persons:

Name	Professional Occupation (1)	Age	Director Since
Nominees for Director for Terms of Office Continuing Until 2000			
Reuben V. Anderson	Mr. Anderson is a member, in the Jackson, Mississippi office, of Phelps Dunbar, a New Orleans law firm. Prior to joining this law firm, he was a justice of the Supreme Court of Mississippi. Mr. Anderson is a director of Trustmark National Bank and BellSouth Corporation. He is chair of the Social Responsibility Committee and a member of the Audit Committee.	54	1991
Clyde R. Moore	Mr. Moore is President, Chief Operating Officer, and a director of Thomas & Betts Corporation, a manufacturer of electrical and electronic components. He has been elected President and Chief Executive Officer of Thomas & Betts Corporation effective May 7, 1997. Prior to this Mr. Moore held a variety of senior operating positions at Thomas & Betts Corporation and FL Industries, Inc. Mr. Moore is a member of the advisory board of the American Manufacturing Corporation.	43	—
John D. Ong	Mr. Ong is Chairman of The BFGoodrich Company, a chemical and aerospace company. He is a director of Cooper Industries, Inc.; Ameritech Corporation; The Geon Company; ASARCO Inc.; and TRW Inc. Mr. Ong is vice chair of the Financial Policy Committee and a member of the Corporate Governance and Executive Committees.	63	1975
Joseph A. Pichler	Mr. Pichler is Chairman of the Board and Chief Executive Officer of Kroger. He is a director of The BFGoodrich Company and Cincinnati Milacron. Mr. Pichler is chair of the Executive Committee.	57	1983

Name	Professional Occupation (1)	Age	Director Since
Martha Romayne Seger	Dr. Seger is a Financial Economist and currently is a Distinguished Visiting Professor at Central Michigan University. From 1991-1993 she was the John M. Olin Distinguished Fellow at The Karl Eller Center of the University of Arizona. She was a member of the Board of Governors of the Federal Reserve System from 1984-1991. She is a director of Amerisure Companies; Amoco Corporation; Providian Corporation; Fluor Corporation; Johnson Controls, Inc.; Tucson Electric Power Company; and Xerox Corporation. Dr. Seger is a member of the Financial Policy and Social Responsibility Committees.	65	1991
	Directors Whose Terms of Office Continue Until 1999		
Richard W. Dillon	Mr. Dillon is Chairman Emeritus of the Board of Dillon Companies, Inc., a wholly-owned subsidiary of Kroger. Mr. Dillon is a member of the Financial Policy Committee.	69	1983
John T. LaMacchia	Mr. LaMacchia is President, Chief Executive Officer, and a director of Cincinnati Bell Inc., a telecommunications holding company. He is chair of the Audit Committee and a member of the Compensation and Executive Committees.	55	1990
Edward M. Liddy	Mr. Liddy is President, Chief Operating Officer, and a director of the Allstate Corporation, the largest publicly held personal lines insurance company in the United States. Prior to this he was Senior Vice President and Chief Financial Officer of Sears, Roebuck and Co., where he held a variety of senior operating and financial positions since 1988. Mr. Liddy also serves as a non-executive Chairman of the Board of The PMI Group, Inc., the third largest private mortgage insurer in the United States. He is a member of the Audit and Financial Policy Committees.	51	1996
T. Ballard Morton, Jr.	Mr. Morton is Executive in Residence of the College of Business & Public Administration of the University of Louisville. He is a director of PNC Bank, Kentucky, Inc. and LG&E Energy Corp. Mr. Morton is chair of the Financial Policy Committee, vice chair of the Compensation Committee, and a member of the Executive Committee.	64	1968
Katherine D. Ortega	Ms. Ortega served as an Alternate Representative of the United States to the 45th General Assembly of the United Nations in 1990-1991. Prior to that, she served as Treasurer of the United States. Ms. Ortega is a director of Ultramar Diamond Shamrock Corporation; Ralston Purina Co.; Long Island Lighting Company; The Paul Revere Corporation; and Rayonier Inc. She is vice chair of the Audit Committee and a member of the Social Responsibility Committee.	62	1992

Name	Professional Occupation (1)	Age	Director Since
	DIRECTORS WHOSE TERMS OF OFFICE CONTINUE UNTIL 1998		
John L. Clendenin	Mr. Clendenin is Chairman of the Board of BellSouth Corporation, a holding company with subsidiaries in the telecommunications business. He is a director of Wachovia Corp.; Equifax Incorporated; Providian Corporation; RJR Nabisco Holdings Corp.; Springs Industries, Inc.; Coca Cola Enterprises, Inc.; The Home Depot, Inc.; and National Service Industries, Inc. Mr. Clendenin is chair of the Corporate Governance Committee and a member of the Social Responsibility Committee.	62	1986
David B. Dillon	Mr. Dillon was elected President and Chief Operating Officer of Kroger in 1995. Prior to this he was elected Executive Vice President in 1990; Chairman of the Board of Dillon Companies, Inc., a wholly-owned subsidiary of Kroger, in 1992; and President of Dillon Companies, Inc., in 1986. He is a director of the First National Bank of Hutchinson, Kansas. Mr. Dillon is vice chair of the Executive Committee.	46	1995
Patricia Shontz Longe	Dr. Longe is an Economist and a Senior Partner of The Longe Company, an economic consulting and investment firm. She is a director of The Detroit Edison Company; DTE Energy Company; Jacobson Stores, Inc.; Comerica, Inc.; Comerica Bank & Trust, FSB; and Warner-Lambert Company. Dr. Longe is vice chair of the Corporate Governance Committee and a member of the Compensation Committee.	63	1977
Thomas H. O'Leary	Mr. O'Leary is Chairman of Burlington Resources Inc., a natural resources business. He is a director of The BFGoodrich Company. Mr. O'Leary is chair of the Compensation Committee and a member of the Corporate Governance Committee.	63	1977
James D. Woods	Mr. Woods is Chairman Emeritus and Consultant of Baker Hughes Incorporated, a company that provides equipment and services to the petroleum and process industries. He is a director of Union Texas Petroleum Holdings Inc., Varco International, and Wynn's International Inc. Mr. Woods is vice chair of the Social Responsibility Committee and a member of the Audit Committee.	65	1994

(1) Except as noted, each of the directors has been employed by his or her present employer (or a subsidiary) in an executive capacity for at least five years.

Information Concerning The Board Of Directors

Directors' Compensation

Each non-employee director is currently paid an annual retainer of $28,000 plus fees of $1,500 for each board meeting and $1,000 for each committee meeting attended. Committee chairs receive an additional annual retainer of $4,000. Directors who are employees of the Company receive no compensation for service as directors. The Company provides accidental death and disability insurance for directors at a cost to the Company in 1996 of $167 per director. The Company also provides a major medical plan for directors.

Under the 1994 Long-Term Incentive Plan, in 1996 the Company granted to each of its non-employee directors owning a minimum of 1,000 shares of Company common stock as of the date of the annual meeting of shareholders, options to purchase 2,000 shares of common stock at an option price equal to the fair market value of the stock at the date of the grant, and each non-employee director received a grant on that date. The options vest in 666, 667 and 667 share amounts on the first, second, and third annual anniversary of the date of grant. Based on the closing price of Kroger stock on the New York Stock Exchange, as of December 28, 1996, the value of each grant of options made in 1996, none of which were exercisable, was $10,860. If the shareholders approve the 1997 Long-Term Incentive Plan, these grants to directors will continue on the same terms except that the vesting period will increase to five years.

The Company has an unfunded retirement program for outside directors. The retirement benefit is the average compensation for the five calendar years preceding retirement. Directors who retire from the Board prior to age 70 will be credited with 50% vesting after five years of service and an additional 10% for each year served thereafter. Benefits for directors who retire prior to age 70 will commence at the time of retirement from the Board or age 65, whichever comes later.

Committees Of The Board

The Board of Directors has a number of standing committees including Audit, Compensation, and Corporate Governance Committees. During 1996, the Audit Committee met three times, the Compensation Committee met three times, and the Corporate Governance Committee met two times. Committee memberships are shown on pages 6 through 8 of this Proxy Statement. The Audit Committee reviews external and internal auditing matters and recommends the selection of the Company's independent auditors for approval by the Board and ratification by shareholders. The Compensation Committee determines the compensation of the Company's senior management and administers its stock option and benefit programs. The Corporate Governance Committee is responsible for developing criteria for selecting and retaining members of the Board; seeks out qualified candidates for the Board; and reviews the performance of the Company, the Chief Executive Officer, and the Board. The Board of Directors met seven times in 1996. During 1996, all directors attended at least 75% of the aggregate number of Board meetings and committee meetings on which that director was a member, with the exception of Mr. Ong and Dr. Seger.

The Corporate Governance Committee will consider shareholder recommendations for nominees for membership on the Board of Directors. Recommendations relating to the Company's annual meeting in May 1998, together with a description of the proposed nominee's qualifications and other relevant information, must be submitted in writing to Paul W. Heldman, Secretary of the Company, and received at the Company's executive offices not later than December 6, 1997.

Certain Transactions

The law firm of Gilliland & Hayes, of which Bradley D. Dillon, son of Richard W. Dillon, is a partner, rendered legal services to subsidiaries of the Company which resulted in fees paid to the law firm in 1996 of $202,305. The management of the Company has determined that these amounts paid by the Company for the services are fair and competitive.

In addition, the law firm of Phelps Dunbar, of which Reuben V. Anderson is a partner, rendered legal services to the Company which resulted in fees paid to the law firm by the Company in 1996 of $17,779. The management of the Company has determined that amounts paid by the Company for the services are fair and competitive.

Compensation of Executive Officers

Summary Compensation

The following table shows the compensation for the past three years of the Chief Executive Officer and each of the Company's four most highly compensated executive officers, excluding the Chief Executive Officer (the "named executive officers"):

SUMMARY COMPENSATION TABLE

		Annual Compensation			Long Term Compensation(1) Awards		
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)	Restricted Stock Awards ($)	Securities Underlying Options/SARs (#)	All Other Compensation ($)
				(2)	(3)	(4)	(5)
Joseph A. Pichler	1996	$452,400	$486,893	$18,741		30,000	$ 26,760
Chairman and Chief	1995	$447,046	$614,197	$16,412		30,000	$ 24,300
Executive Officer	1994	$430,385	$684,447	$19,511		27,000	$ 23,023
David B. Dillon	1996	$326,977	$321,773	$ 5,186		18,000	$504,955(6)
President and Chief	1995	$305,083	$309,731	$ 4,456	$332,250	25,000	$ 31,166(7)
Operating Officer	1994	$290,000	$281,059			15,000	$ 1,650
Patrick J. Kenney	1996	$278,100	$258,455	$15,732		15,000	$ 22,085
Executive Vice President	1995	$262,308	$293,688	$12,291	$138,437	20,000	$ 18,065
	1994	$250,000	$277,959	$12,840	$205,625	15,000	$ 17,012
Michael S. Heschel	1996	$268,100	$258,455	$ 9,275		25,000	$ 13,470
Executive Vice President	1995	$252,308	$293,688	$ 7,389	$138,437	20,000	$ 11,633
	1994	$240,000	$277,959	$ 8,653	$205,625	15,000	$ 11,093
Ronald R. Rice	1996	$223,692	$155,080	$13,186		15,000	$ 19,411
Senior Vice President	1995	$215,885	$194,364	$10,984	$ 93,500	15,000	$ 17,130
	1994	$202,615	$214,049	$11,656		20,000	$ 15,374

(1) During the period presented, the Company has made no long-term incentive plan payouts other than restricted stock and stock options.

(2) Represents reimbursement for the tax effects of payment for certain premiums on a policy of life insurance.

(3) Messrs. Pichler, Dillon, Kenney, Heschel, and Rice had 100,000, 9,600, 13,000, 13,000, and 1,334 shares outstanding, respectively, at December 28, 1996, with an aggregate value of $4,625,000, $444,000, $601,250, $601,250, and $61,978, respectively. The aggregate value is based on the market price of the Company's common stock on December 28, 1996. Restrictions remaining on outstanding restricted stock awards to Mr. Pichler in 1995 lapse in January 2000, based on performance goals achieved in 1995 through 1999 and more particularly described in the Compensation Committee Report which follows. The shares will vest immediately if Mr. Pichler leaves the Company due to death or disability or in the event of a change in control of the Company. The restrictions remaining on Mr. Dillon's 1995 restricted stock grant lapse in equal amounts over the next four years. The restrictions remaining on Messrs. Kenney and Heschel's outstanding restricted stock awards lapse as to 1,500 shares over each of the next two years, 9,000 shares in 1999, and 1,000 shares in 2000. The restrictions remaining on outstanding restricted stock awards to Mr. Rice lapse on 1,334 shares in 1997. The Company is currently prohibited by contract from paying dividends on its common stock but, should this prohibition be lifted, dividends, as and when declared, would be payable on these shares.

(4) Represents options granted during the respective fiscal year. Options vest for equal number of shares in the three succeeding years from the date of grant. Options terminate in 10 years if not earlier exercised or terminated. No stock appreciation rights ("SARs") were granted in any of the three years presented.

(5) For 1996, these amounts include the Company's matching contribution under The Kroger Co. Savings Plan in the amounts of $450, $900, $0, $450, and $900, respectively, for Messrs. Pichler, Dillon, Kenney, Heschel and Rice and reimbursement of certain premiums for policies of life insurance in the amounts of $26,310, $7,280, $22,085, $13,020 and $18,511, respectively, for Messrs. Pichler, Dillon, Kenney, Heschel, and Rice.

(6) $496,775 of this amount represents an additional payment to Mr. Dillon pursuant to the Company's relocation program.

(7) $23,154 of this amount represents an additional payment to Mr. Dillon pursuant to the Company's relocation program.

Stock Option/Stock Appreciation Right Grants

The Company has in effect employee stock option plans pursuant to which options to purchase common stock of the Company are granted to officers and other employees of the Company and its subsidiaries. The following table shows option grants in fiscal year 1996 to the named executive officers:

OPTION/SAR GRANTS IN LAST FISCAL YEAR

	Individual Grants				Potential Realizable Value at Assumed Rates of Stock Price Appreciation for Option Term		
Name	Number of Securities Underlying Options/SARs Granted(1) (#)	% of Total Options/SARs Granted to Employees in Fiscal Year	Exercise or Base Price ($/Share)	Expiration Date	0%	5%	10%
Joseph A. Pichler	30,000	1.06%	$41.50	4/17/2006	$0	$782,974	$1,984,209
David B. Dillon	18,000	0.64%	$41.50	4/17/2006	$0	$469,784	$1,190,526
Patrick J. Kenney	15,000	0.53%	$41.50	4/17/2006	$0	$391,487	$ 992,105
Michael S. Heschel	25,000	0.89%	$41.50	4/17/2006	$0	$652,478	$1,653,508
Ronald R. Rice	15,000	0.53%	$41.50	4/17/2006	$0	$391,487	$ 992,105

(1) No SARs were granted or outstanding during the fiscal year. These options vest in equal number of shares in 1997, 1998 and 1999, and terminate in 10 years if not earlier exercised or terminated.

The assumptions set forth in the chart above are merely examples and do not represent predictions of future stock prices or a forecast by the Company with regard to stock prices.

Aggregated Option/SAR Exercises in Fiscal Year and Option/SAR Values

The following table shows information concerning the exercise of stock options during fiscal year 1996 by each of the named executive officers and the fiscal year-end value of unexercised options:

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND FY-END OPTION/SAR VALUES TABLE

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options/SARs at F/Y End (1) (#) Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options/SARs at F/Y End (1) ($) Exercisable/ Unexercisable
Joseph A. Pichler	0	$ 0	242,080/59,000	$7,655,631/$763,330
David B. Dillon	24,505	$767,857	136,333/39,667	$4,257,010/$532,550
Patrick J. Kenney	0	$ 0	153,035/31,666	$5,061,187/$416,878
Michael S. Heschel	33,333	$579,477	4,999/41,668	$ 107,147/$464,378
Ronald R. Rice	4,000	$100,240	61,332/31,668	$1,573,133/$431,247

(1) No SARs were granted or outstanding during the fiscal year.

As of March 1, 1997, senior officers held options to acquire stock of the Company that expire in varying amounts from 1997 through 2006. Of these options, 27,550, 164,733, and 11,000, expire in 1997, 1998, and 1999, respectively. It is expected that these options will be exercised prior to their expiration.

LONG-TERM INCENTIVE PLAN AWARDS

The Company made no Long-Term Incentive Plan awards, excluding stock options and restricted stock, to any named executive officer during fiscal year 1996.

COMPENSATION COMMITTEE REPORT

The Company's compensation policies are applicable to virtually all levels of its work force, including its executive officers. These policies require the Company to:

- be competitive in total compensation;
- include, as part of total compensation, opportunities for equity ownership;
- use incentives that offer more than competitive compensation when the Company achieves superior results;
- base incentive payments on earnings before interest, taxes, depreciation and LIFO charges ("EBITD") and on sales results.

Accordingly, the Company's compensation plans include grants of stock options for executive, management, and hourly employees. In determining the size of option grants to the Chief Executive Officer and the other executive officers, the Compensation Committee considers, without use of a formula, competitive practices among retailers, the individual executive officer's level within Kroger and the level of past awards of stock options and restricted stock to the individual. Grants of options to the Chief Executive Officer and the other executive officers are generally lower than those of their counterparts in the retail industry because the Company grants options to several thousand management and hourly employees instead of, as is common in the industry, only a small group of executives.

The 1994 Long-Term Incentive Plan, approved by the shareholders at the Annual Meeting in 1994, authorized the issuance of 8,000,000 shares of common stock. During 1996, Kroger granted 2,837,510 stock options to approximately 5,000 employees throughout the Company. The number of options granted and the number of employees receiving options was typical of grants made in the past several years. The Company expects to continue to use a broad-based stock option program as a means of attracting and retaining employees, due to the direct relationship between value received by the optionee and shareholder return. At the present time, the shares in the 1994 Long-Term Incentive Plan nearly are exhausted. As a result, the Company is submitting for shareholder approval its 1997 Long-Term Incentive Plan that was adopted by the Board of Directors subject to shareholder approval. (See Item No. 2, below.)

The Compensation Committee establishes the fixed portion of executive officer cash compensation, or salary, by considering internal equity and competitor salary data as described below. Additionally, a large percentage of employees at all levels of the organization, including executive officers, are eligible to receive a bonus incentive based upon Company or unit performance. Bonus potentials for executives are established by level within the Company, and actual payouts are based on achievement of sales and EBITD targets. Actual payouts can exceed these potentials if results exceed the targets. In the case of Mr. Bryant, approximately 33% of total potential cash compensation is based on Dillon EBITD and sales performance. In the case of all other executive officers, approximately 50% of total potential cash compensation is based on Company or unit EBITD and sales performance.

Salary and bonus levels are compared to a grouping of food wholesalers and retailers, the Wholesale/Retail Compensation Survey, from which the peer group is selected (see Performance Graph, below), to ensure that executive and management compensation is competitive. The Committee establishes salaries for executive officers that generally are at the median of compensation paid by peer group companies for comparable positions (where data for comparable positions are available) with a bonus potential that, if realized, would cause their total cash compensation to be in the upper quartile of peer group compensation. The Company's outstanding performance in 1996 is reflected by bonuses paid for all executive officers. Bonus payouts for Messrs. Pichler, Dillon and McMullen are based on combined Kroger and Dillon operations and

represented 84.7% of their potentials. Mr. Bryant's bonus payout is based in total on Dillon operations and represented 55.5% of his potential. Mr. Rice's bonus payout is based in part on the manufacturing group's operations and represented 68.9% of his potential. All other executive officers received bonus payouts of 94.0% of their respective potentials.

The compensation of Kroger's Chief Executive Officer is determined annually pursuant to the policies described above. Mr. Pichler's variable compensation or bonus for the last fiscal year, which represented 84.7% of his bonus potential, reflects the extent to which the Company achieved the EBITD and sales targets that were established by this Committee at the beginning of the year. The value of stock options granted to Mr. Pichler in the last fiscal year fluctuates based on the Company's performance in the stock market.

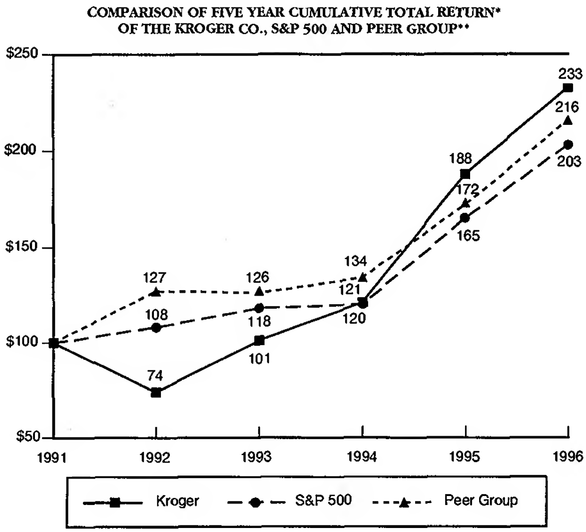
In 1995, the Compensation Committee engaged Towers Perrin to compare the Chief Executive Officer's compensation to that of CEOs of other retailers and found that Mr. Pichler's compensation has not been competitive. As a result, the Board adopted a performance based restricted stock plan and made awards under which Mr. Pichler could earn as many as 100,000 shares over a five-year period. The restrictions on these shares lapse on January 1, 2000, but only as to that number of shares remaining after certain reductions based on a comparison of the Company's shareholder return to that of a group including the peer group. In general, each fiscal year the Chief Executive Officer can earn up to 20,000 of the shares depending upon the extent to which the Company's performance exceeds that of the reference group. On the other hand, up to 10,000 otherwise previously earned shares will be forfeited in those years in which the Company's performance does not exceed the median compared to that same group. In 1995 and 1996, Mr. Pichler tentatively earned 20,000 and 10,000 shares, by virtue of the Company's shareholder return relative to the reference group being in the first quartile and the second quartile, respectively. Mr. Pichler also is party to an employment contract with the Company which is more particularly described elsewhere in the Proxy statement. (See p. 16). That agreement establishes minimum compensation at levels below his total compensation determined in consideration of the factors identified above.

The Omnibus Budget Reconciliation Act of 1993 places a $1,000,000 limit on the amount of certain types of compensation for each of the executive officers that is tax deductible by the Company. The Company believes that its 1994 Long-Term Incentive Plan, and its proposed 1997 Long-Term Incentive Plan, comply with the Internal Revenue Service's final regulations on the deductibility limit. Accordingly, the compensation expense incurred thereunder should be deductible. The Company continues to consider modifications to its other compensation programs based on the final regulations. The Company's policy is, primarily, to design and administer compensation plans that support the achievement of long-term strategic objectives and enhance shareholder value. Where it is material and supports the Company's compensation philosophy, the Committee also will attempt to maximize the amount of compensation expense that is tax deductible by the Company.

Compensation Committee:
Thomas H. O'Leary, Chair
T. Ballard Morton, Jr., Vice-Chair
John T. LaMacchia
Patricia Shontz Longe

Performance Graph

Set forth below is a line graph comparing the five year cumulative total shareholder return on the Company's common stock, based on the market price of the common stock and assuming reinvestment of dividends, with the cumulative total return of companies on the Standard & Poor's 500 Stock Index and the largest food companies selected from the Wholesale/Retail Compensation Survey:



The Company's fiscal year ends on the Saturday closest to December 31.

*Total assumes $100 invested on December 29, 1991 in The Kroger Co., S&P 500 Index, and the largest food companies selected from the Wholesale/Retail Compensation Survey (the "Peer Group"), with reinvestment of dividends.

**The Peer Group consists of Albertson's, Inc., American Stores Company, Fleming Companies, Inc., Giant Food Inc. (Class A), Great Atlantic & Pacific Tea Company, Inc., Safeway Inc., Supervalu Inc., The Vons Companies, Inc., and Winn-Dixie Stores, Inc.

The Company's peer group is composed of the nine largest food companies measured by total revenue (excluding the Company) within the Wholesale/Retail Compensation Survey (the "Survey"), which permits a comparison of the return of the Company's shareholders to that of companies against which executive compensation levels are measured. The Compensation Committee establishes the compensation for executives and management by comparison to compensation reported in the Survey.

Neither the foregoing Compensation Committee Report nor the foregoing Performance Graph will be deemed incorporated by reference into any other filing, absent an express reference thereto.

Compensation Pursuant To Plans

The Company maintains various benefit plans which are available to management and certain other employees. The Company derives the benefit of certain tax deductions as a result of its contributions to some of the plans. Each of the executive officers of the Company was eligible to participate in one or more of the following plans.

The Kroger Co. Employee Protection Plan

The Company adopted The Kroger Co. Employee Protection Plan ("KEPP") during fiscal 1988. All management employees, including the executive officers, and administrative support personnel of the Company with at least one year of service are covered. KEPP provides for severance benefits and the extension of Company paid health care in the event an eligible employee actually or constructively is terminated from employment without cause within two years following a change of control of the Company (as defined in the plan). For persons over 40 years of age with more than six years of service, severance pay ranges from approximately 9 to 18 months' salary and bonus, depending upon Company pay level and other benefits. KEPP may be amended or terminated by the Board of Directors at any time prior to a change of control, and will expire in 1998 unless renewed by the Board of Directors.

Pension Plans

The Company maintains the Kroger Retirement Benefit Plan, a defined benefit plan, to provide pension benefits to retired or disabled management employees and certain groups of hourly personnel. The Plan generally provides for benefits at age 62 or later equal to 1½% times the years of service, after attaining age 21, (or, for participants prior to January 1, 1986, after attaining age 25) times the highest average earnings for any five years during the ten calendar years preceding retirement, less an offset tied to Social Security benefits. The Company also maintains an Excess Benefits Plan under which the Company pays benefits which exceed the maximum benefit payable under ERISA by defined benefit plans. The following table gives examples of annual retirement benefits payable on a straight-life basis under the Company's retirement program.

Five Year Average Remuneration	Years of Service					
	15	20	25	30	35	40
$ 150,000	$ 33,750	$ 45,000	$ 56,250	$ 67,500	$ 78,750	$ 90,000
250,000	56,250	75,000	93,750	112,500	131,250	150,000
450,000	101,250	135,000	168,750	202,500	236,250	270,000
650,000	146,250	195,000	243,750	292,500	341,250	390,000
850,000	191,250	255,000	318,750	382,500	446,250	510,000
900,000	202,500	270,000	337,500	405,000	472,500	540,000
1,200,000	270,000	360,000	450,000	540,000	630,000	720,000
1,300,000	292,500	390,000	487,500	585,000	682,500	780,000

No deductions have been made in the above table for offsets tied to Social Security benefits.

Remuneration earned by Messrs. Pichler, Dillon, Kenney, Heschel, and Rice in 1996, which was covered by the Plan, was $1,066,597, $636,708, $571,788, $561,788, and $418,056, respectively. As of December 28, 1996, they had 9, 1, 35, 5, and 36 years of credited service, respectively.

Dillon Plans

Dillon Companies, Inc. and its subsidiaries maintain pension, profit sharing, stock ownership, and savings plans that provide benefits at levels comparable to the plans described above. David B. Dillon has 20 years of credited service and Joseph A. Pichler has 6 years of credited service under certain of the pension and profit sharing plans, but no further credited service will be accrued for either of them under those plans.

Under the Dillon Employees' Profit Sharing Plan, Dillon and each of its participating subsidiaries contributes a certain percentage of net income, determined annually, to be allocated among participating employees based on the percent that the participating employee's total compensation bears to the total compensation of all participating employees employed by the particular Dillon division or subsidiary. On participating employees' termination upon attaining the age 60, death or disability, they are entitled to their full contribution account balance. In addition to this plan, Dillon and several of its subsidiaries have adopted the Dillon Pension Plan, a defined benefit plan, for their eligible employees. Under the pension plan, the normal retirement benefit for eligible employees is a certain percentage of average compensation during a certain period of employment multiplied by the years of credited service (in some of these plans there is a maximum period of credited service), minus the benefit provided by the Profit Sharing Plan (except as may be limited by provisions of ERISA).

The following table shows the estimated annual pension payable upon retirement to persons covered by Dillon's Plans. Benefits payable under the Profit Sharing Plan may exceed the amount payable under the Pension Plan, and participants are entitled to the greater of the two. The table does not reflect benefits payable under Dillon's Profit Sharing Plan, since benefits under that plan are not determined by years of service, and no deductions have been made in the table for offsets tied to Social Security benefits. Dillon also maintains an Excess Benefit Plan that pays benefits which exceed the maximum benefit payable under ERISA by defined benefit and defined contribution plans.

Average Compensation	Years of Service					
	15	20	25	30	35	40
$150,000	$ 33,750	$ 45,000	$ 56,250	$ 67,500	$ 78,750	$ 90,000
250,000	56,250	75,000	93,750	112,500	131,250	150,000
300,000	67,500	90,000	112,500	135,000	157,500	180,000
400,000	90,000	120,000	150,000	180,000	210,000	240,000
500,000	112,500	150,000	187,500	225,000	262,500	300,000
600,000	135,000	180,000	225,000	270,000	315,000	360,000
700,000	157,500	210,000	262,500	315,000	367,500	420,000

The amounts contributed by Dillon and its subsidiaries pursuant to these retirement plans are not readily ascertainable for any individual, and thus are not set forth above.

Employment Contracts

The Company entered into an amended and restated employment agreement with Mr. Pichler dated as of July 22, 1993. During his employment, the Company agrees to pay Mr. Pichler at least $420,000 a year, unless the amount is reduced due to adverse business conditions. Mr. Pichler's employment may be terminated at the discretion of the Board of Directors. The contract also provides that the Company will continue to pay Mr. Pichler's salary to his beneficiary for a period of five years after a termination of employment resulting from his death, or will pay to Mr. Pichler his salary for a term equal to the lesser of five years or until October 4, 2005, if Mr. Pichler's termination of employment results from his involuntary separation. The Company also has agreed to reimburse Mr. Pichler for premiums on a policy of life insurance plus the tax effects of that reimbursement. After his termination of employment for any reason after age 62, if he is not entitled to receive the salary continuation described above, Mr. Pichler will, in exchange for his availability to provide certain consulting services, then receive each year until his death an amount equal to 25% of the highest salary paid him during the term of this agreement.

Beneficial Ownership Of Common Stock

As of February 7, 1997, the directors of the Company, the named executive officers and the directors and executive officers as a group, beneficially owned shares of the Company's common stock as follows:

Name	Amount and Nature of Beneficial Ownership
Reuben V. Anderson	2,999(8)
John L. Clendenin	2,999(8)
David B. Dillon	247,854(1)(6)(7)
Richard W. Dillon	175,624(2)(8)
Michael S. Heschel	14,157(6)(7)
Patrick J. Kenney	178,433(6)(7)
John T. LaMacchia	2,999(8)
Edward M. Liddy	2,400
Patricia Shontz Longe	5,999(8)
T. Ballard Morton, Jr.	11,999(8)
Thomas H. O'Leary	2,999(8)
John D. Ong	2,999(8)
Katherine D. Ortega	3,588(8)
Joseph A. Pichler	513,915(3)(6)(7)
Ronald R. Rice	78,083(6)(7)
Martha Romayne Seger	3,199(8)
James D. Woods	2,999(8)
Directors and Executive Officers as a group (including those named above)	1,764,537(4)(5)(6)(7)

(1) This amount does not include 32,330 shares owned by Mr. Dillon's wife, 13,506 shares in his children's trust or 12,084 shares owned by his children. Mr. Dillon disclaims beneficial ownership of these shares.

(2) This amount does not include 93,116 shares owned by Mr. Richard Dillon's wife. Mr. Dillon disclaims beneficial ownership of these shares.

(3) This amount does not include 2,000 shares owned by Mr. Pichler's wife or 1,508 shares owned by his son. Mr. Pichler disclaims beneficial ownership of these shares.

(4) The figure shown does not include an aggregate of 14,652 additional shares held by, or for the benefit of, the immediate families or other relatives of all directors and executive officers as a group not previously listed above. In each case the director or executive officer disclaims beneficial ownership of those shares.

(5) No director or executive officer owned as much as 1% of common stock of the Company. The directors and executive officers as a group beneficially owned 1.4% of common stock of the Company.

(6) This amount includes shares which represent options exercisable on or before April 8, 1997, in the following amounts: Mr. David Dillon, 136,333; Mr. Heschel, 0; Mr. Kenney, 153,035; Mr. Pichler, 230,080; Mr. Rice, 61,332; and all directors and executive officers as a group, 992,594.

(7) The fractional interest resulting from allocations under Kroger's 401(k) plan and Dillon's ESOP and 401(k) plan has been rounded to the nearest whole number.

(8) This amount includes 1,999 shares which represent options exercisable on or before April 8, 1997.

As of February 7, 1997, the following persons reported beneficial ownership of the Company's common stock based on reports on Schedule 13G filed with the Securities and Exchange Commission or other reliable information as follows:

Name	Address of Beneficial Owner	Amount and Nature of Ownership	Percentage of Class
The Kroger Co. Savings Plan	1014 Vine Street Cincinnati, OH 45202	14,068,358(1)	11.1%
The Dillon Cos. Employee Master Trust	700 East 30th Street Hutchinson, KS 67052	8,318,623(1)	6.5%

(1) Shares beneficially owned by plan trustees for the benefit of participants in employee benefit plans.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission and the New York Stock Exchange. Those officers, directors, and shareholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on its review of the copies of forms received by the Company, or written representations from certain reporting persons that no Forms 5 were required for those persons, the Company believes that during fiscal year 1996 all filing requirements applicable to its officers, directors and ten percent beneficial owners were satisfied except that Mr. Richard W. Dillon inadvertently filed an amended Form 4, reporting a sale of 5,086 shares by a trust under which he is a co-trustee and a beneficiary, four days late, and Mr. James R. Thorne inadvertently filed a Form 4, reporting the sale of a fractional share resulting from the closing of an account under an employee benefit plan, eight days late.

APPROVAL OF THE 1997 LONG-TERM INCENTIVE PLAN
(ITEM NO. 2)

The Board of Directors has adopted, subject to shareholder approval, The Kroger Co. 1997 Long-Term Incentive Plan ("Plan") for which a maximum of 10,000,000 shares of common stock will be reserved. The purpose of the Plan is to assist in attracting and retaining employees and directors of outstanding ability and to promote the identification of their interests with those of the shareholders of the Company. If approved, the Plan will be effective as of May 15, 1997. On March 20, 1997, Board of Directors adopted a resolution to make a distribution in the nature of a 2-for-1 stock split to shareholders of record on April 4, 1997. The stock split will not, therefore, increase the number of shares available under the Plan.

In 1988, the Company instituted a broad-based stock option program designed to motivate employees at all levels of the organization. In 1996 the stock option committee made grants of stock options to approximately 5,000 employees. This program was adopted in efforts to more closely align the interests of employees and shareholders, as stock appreciation will benefit both non-employee shareholders and employees. The 1997 Long-Term Incentive Plan continues this policy.

The stock option committee currently intends to modify the manner in which stock options granted to approximately 100 of the most senior executives will vest. Performance based options will comprise half of the grant made to these individuals. These options will vest during the first four years from the date of the grant only if the Company's stock price has achieved a 63% appreciation from the option price. Thereafter, the options

vest only if the Company's stock price has achieved a minimum of a 13% appreciation per annum from the date of grant or 200% appreciation, whichever is less. The other half of the options granted to these individuals are expected to vest in equal installments over five years from the date of grant. The stock option committee will implement these limitations on vesting for the general grant to be made in 1997. It will consider these same limitations and other alternatives for future grants.

Description of the Plan

General. The Plan consists of three separate programs; the Insider Program, the Non-Insider Program and the Outside Director Program. Officers of the Company, including inside directors, subject to Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act") are eligible for grants or awards under the Insider Program while all other employees of the Company are eligible for grants or awards under the Non-Insider Program. Non-employee directors will receive grants under the Outside Director Program as more particularly described below. Currently, 13 officers are eligible to participate in the Insider Program and the remaining approximately 200,000 employees of the Company are eligible to participate in the Non-Insider Program. Grants will be made under the Outside Director Program to all non-employee directors who own a minimum of 1,000 shares of common stock of the Company on the date of the grant. As of February 7, 1997, all twelve of the non-employee directors are eligible for grants under the Outside Director Program.

Administration. The Insider Program and the Outside Director Program will be administered by a committee of the Board of Directors which meets the standards of Rule 16b-3(d)(1) under the Exchange Act and initially will be those members of the Compensation Committee of the Board of Directors who qualify as "outside directors" under Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"). The Non-Insider Program will be administered by a committee appointed by the Chief Executive Officer, the members of which are ineligible to receive grants or awards under the Non-Insider Program. The administering committee in each case is referred to as the "Committee."

The Committee is authorized to grant nonstatutory stock options and to award restricted stock to participants under the Insider Program and the Non-Insider Program. Annually, the Committee will grant to eligible participants under the Outside Director Program a nonstatutory stock option to purchase 2,000 shares of common stock of the Company. The Committee will determine the types and amounts of awards or grants, the recipients of awards or grants, vesting schedules, restrictions, performance criteria, and other provisions of the grants or awards. All of these provisions will be set forth in a written agreement with the participant.

In addition to other rights of indemnification they may have as directors or employees of the Company, members of the Committee will be indemnified by the Company for reasonable expenses incurred in connection with defense of any action brought against them by reason of action taken or failure to act under or in connection with the Plan or any grant or award thereunder, if the members acted in good faith and in a manner which they believed to be in the best interests of the Company.

The Board of Directors may terminate or amend the Plan at any time without shareholder approval, except that it may not amend the Plan without shareholder approval if required by applicable law, regulations, or rules of the principal exchange or interdealer quotation system on which the common stock is listed or quoted. Unless earlier terminated by the Board of Directors, the Plan will terminate on February 21, 2007. Termination of the Plan will have no effect on the validity of any options or restricted stock outstanding on the date of termination. Unless otherwise provided in the agreement, awards and grants will not be transferable other than by will or the laws of descent and distribution.

Shares Subject to Grant. Under the Plan up to 10,000,000 authorized but unissued or reacquired shares of common stock may be issued upon the exercise of nonstatutory stock options and as restricted stock. In no event may any participant receive awards and grants totaling more than 300,000 shares of common stock in the aggregate under the Plan.

If an option expires, or if restricted stock is not issued or is forfeited prior to the payment of a dividend on those shares to a participant, the shares not exercised, unissued or forfeited, as the case may be, will generally become available for other grants or awards under the Plan.

Outside Director Program. The Outside Director Program is a formula plan in which non-employee directors who own at least 1,000 shares of common stock of the Company at the time of the grant will receive annually during each of 1997 through 1999, a nonstatutory stock option to purchase 2,000 shares of common stock at an option price equal to the fair market value of the common stock on the date of the grant. The option generally will have a 10-year term (subject to earlier termination in the event of termination of Board membership other than by reason of retirement) and will vest in equal share amounts, respectively, on the five annual anniversary dates from the date of grant. The Plan provides for the first grant to eligible directors of nonstatutory options covering 2,000 shares of common stock to be made on May 15, 1997, subject to approval by the Company's stockholders of the Plan.

Stock Options. Nonstatutory stock options granted under the Plan will have exercise prices not less than the greater of the fair market value per share of the optioned stock or the par value of a share of common stock, a term of not more than ten years after the date of grant, and generally may not be exercised before six months from the date of grant. Subject to the terms of the Plan, the Committee determines the vesting schedule and other terms and conditions applicable to stock options granted to employees. An eligible participant may receive more than one option.

The Committee may in its discretion provide for the payment of the option exercise price otherwise than in cash, including by delivery of common stock, valued at its fair market value on the date of exercise, or by a combination of both cash and common stock.

Restricted Stock. The Committee may award restricted stock to participants. The stock will be subject to forfeiture, restrictions on transferability, and other restrictions as specified in the agreement. The Committee has authority to impose other terms and conditions as it may determine in its discretion including making the vesting of awards contingent on the achievement of performance goals. Performance goals may be established by the Committee and may be based on earnings or earnings growth; sales; return on assets, equity or investment; total shareholder return; regulatory compliance; satisfactory internal or external audits; improvement of financial ratings; achievement of balance sheet or income statement objectives or any other objective goals established by the Committee and may be absolute in terms or measured against or in relation to other companies comparably, or otherwise situated to the Company. During the period that a restricted stock award is subject to restrictions, an employee has the right to vote the shares and to receive dividends. The maximum number of shares of restricted stock that can be issued under the Plan is 500,000.

Certain Federal Income Tax Consequences

Nonstatutory Stock Options. A grantee will not recognize income on the grant of a nonstatutory stock option but generally will recognize ordinary income upon the exercise thereof. The amount of income recognized upon the exercise of a nonstatutory stock option generally will be measured by the excess, if any, of the fair market value of the shares at the time of exercise over the exercise price, provided the shares issued are either transferable or not subject to a substantial risk of forfeiture.

In the case of ordinary income recognized by a grantee as described above in connection with the exercise of a nonstatutory stock option, the Company will be entitled to a deduction in the amount of ordinary income so recognized by the grantee, provided the Company satisfies certain federal income tax reporting requirements.

Restricted Stock. The recipient of restricted stock is not required to include the value of these shares in ordinary income until the first time the grantee's rights in the shares are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, unless the grantee elects to be taxed on receipt of the shares. In either case, the amount of income will be equal to the excess of the fair market value of the stock at

the time the income is recognized over the amount paid for the stock. The Company will be entitled to a deduction in the amount of the ordinary income recognized by the grantee for the Company's taxable year which includes the last day of the grantee's taxable year in which the grantee recognizes the income, provided the Company satisfies certain federal income tax reporting requirements.

General. The rules governing the tax treatment of options and restricted stock and stock acquired upon the exercise of options are quite technical, so that the above description of tax consequences is necessarily general in nature and does not purport to be complete. Moreover, statutory provisions are, of course, subject to change, as are their interpretations, and their application may vary in individual circumstances. Finally, the tax consequences under applicable state law may not be the same as under the federal income tax laws.

Tax Deductibility Cap. Section 162(m) of the Code provides that certain compensation received in any year by a "covered employee" in excess of $1,000,000 is non-deductible by the Company for federal income tax purposes. Section 162(m) provides an exception, however, for "performance-based compensation." The Committee currently intends to structure grants and awards made under the Plan to "covered employees" as performance-based compensation that is exempt from Section 162(m).

New Plan Benefits

	1997 Long-Term Incentive Plan	
Name and Position(1)	**Dollar Value**	**Number of Units**
Non-Executive Director Group	$0(2)	24,000(3)

(1) Awards, values and benefits are not determinable for other than the Non-Executive Director Group.

(2) Options to be granted to Non-Executive Directors upon approval of shareholders at fair market value of stock.

(3) Based on number of eligible Non-Executive Directors as of February 7, 1997.

THE BOARD OF DIRECTORS AND MANAGEMENT RECOMMEND A VOTE FOR THIS PROPOSAL

SELECTION OF AUDITORS
(ITEM NO. 3)

The Board of Directors, on February 21, 1997, appointed the firm of Coopers & Lybrand L.L.P. as Company auditors for 1997, subject to ratification by shareholders. This appointment was recommended by the Company's Audit Committee, comprised of directors who are not employees of the Company. If the firm is unable for any reason to perform these services, or if selection of the auditors is not ratified, other independent auditors will be selected to serve. Ratification of this appointment requires the adoption of the following resolution by the affirmative vote of the holders of a majority of the shares represented at the meeting:

"RESOLVED, That the appointment by the Board of Directors of Coopers & Lybrand L.L.P. as Company auditors for 1997 be, and it hereby is, ratified."

Fees for all audit services provided by Coopers & Lybrand L.L.P. in 1996 totaled $682,849. In addition, fees totaling $70,651 were charged for non-audit services.

A representative of Coopers & Lybrand L.L.P. is expected to be present at the meeting to respond to appropriate questions and to make a statement if he or she desires to do so.

THE BOARD OF DIRECTORS AND MANAGEMENT RECOMMEND A VOTE FOR THIS PROPOSAL.

SHAREHOLDER PROPOSALS—1998 ANNUAL MEETING. Shareholder proposals intended for inclusion in the Company's proxy material relating to the Company's annual meeting in May 1998 should be addressed to the Secretary of the Company and must be received at the Company's executive offices not later than December 6, 1997.

Attached to this Proxy Statement is the Company's 1996 Annual Report which includes a brief description of the Company's business indicating its general scope and nature during 1996, together with the audited financial information contained in the Company's 1996 report to the Securities and Exchange Commission on Form 10-K. **A copy of that report is available to shareholders on request by writing: Lawrence M. Turner, Vice President and Treasurer, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45202-1100 or by calling 1-513-762-1220.**

The management knows of no other matters that are to be presented at the meeting but, if any should be presented, the Proxy Committee expects to vote thereon according to its best judgment.

By order of the Board of Directors,

Paul W. Heldman, Secretary

1996 Annual Report

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of The Kroger Co. has the responsibility for preparing the accompanying financial statements and for their integrity and objectivity. The statements were prepared in accordance with generally accepted accounting principles applied on a consistent basis and are not misstated due to material error or fraud. The financial statements include amounts that are based on management's best estimates and judgments. Management also prepared the other information in the report and is responsible for its accuracy and consistency with the financial statements.

The Company's financial statements have been audited by Coopers & Lybrand L.L.P., independent certified public accountants, approved by the shareholders. Management has made available to Coopers & Lybrand L.L.P. all of the Company's financial records and related data, as well as the minutes of stockholders' and directors' meetings. Furthermore, management believes that all representations made to Coopers & Lybrand L.L.P. during its audit were valid and appropriate.

Management of the Company has established and maintains a system of internal control that provides reasonable assurance as to the integrity of the financial statements, the protection of assets from unauthorized use or disposition, and the prevention and detection of fraudulent financial reporting. The system of internal control provides for appropriate division of responsibility and is documented by written policies and procedures that are communicated to employees with significant roles in the financial reporting process and updated as necessary. Management continually monitors the system of internal control for compliance. The Company maintains a strong internal auditing program that independently assesses the effectiveness of the internal controls and recommends possible improvements thereto. In addition, as part of its audit of the Company's financial statements, Coopers & Lybrand L.L.P. completed a review of selected internal accounting controls to establish a basis for reliance thereon in determining the nature, timing and extent of audit tests to be applied. Management has considered the internal auditor's and Coopers & Lybrand L.L.P.'s recommendations concerning the Company's system of internal control and has taken actions that we believe are cost-effective in the circumstances to respond appropriately to these recommendations. Management believes that, as of December 28, 1996, the Company's system of internal control is adequate to accomplish the objectives discussed herein.

Management also recognizes its responsibility for fostering a strong ethical climate so that the Company's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in the Company's code of corporate conduct, which is publicized throughout the Company. The code of conduct addresses, among other things, the necessity of ensuring open communication within the Company; potential conflicts of interests; compliance with all domestic and foreign laws, including those relating to financial disclosure; and the confidentiality of proprietary information. The Company maintains a systematic program to assess compliance with these policies.

Joseph A. Pichler
Chairman of the Board and
Chief Executive Officer

W. Rodney McMullen
Group Vice President and
Chief Financial Officer

AUDIT COMMITTEE CHAIRMAN'S LETTER

The Audit Committee of the Board of Directors is composed of five independent directors. The committee held three meetings during fiscal year 1996. In addition, members of the committee received and reviewed various reports from the Company's internal auditor and from Coopers & Lybrand L.L.P. throughout the year.

The Audit Committee oversees the Company's financial reporting process on behalf of the Board of Directors. In fulfilling its responsibility, the Committee recommended to the Board of Directors, subject to shareowner approval, the selection of the Company's independent public accountant, Coopers & Lybrand L.L.P. The Audit Committee discussed with the Company's internal auditor and Coopers & Lybrand L.L.P. the overall scope and specific plans for their respective audits. The committee also discussed the Company's consolidated financial statements and the adequacy of the Company's internal controls. At each meeting, the Committee met with the Company's internal auditor and Coopers & Lybrand L.L.P., in each case without management present, to discuss the results of their audits, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting. Those meetings also were designed to facilitate any private communications with the Committee desired by the Company's internal auditor or Coopers & Lybrand L.L.P.

John T. LaMacchia
Chairman—Audit Committee

The Company

The Kroger Co. (the "Company") was founded in 1883 and incorporated in 1902. As of December 28, 1996 the Company was the largest grocery retailer in the United States based on annual sales. The Company also manufactures and processes food for sale by its supermarkets. The Company's principal executive offices are located at 1014 Vine Street, Cincinnati, Ohio 45202 and its telephone number is (513) 762-4000.

As of December 28, 1996, the Company operated 1,356 supermarkets, most of which are leased. Of this number, 1,105 supermarkets were operated principally under the Kroger name in the Midwest and South. Dillon Companies, Inc. ("Dillon"), a wholly-owned subsidiary of the Company, operated 251 supermarkets directly or through wholly-owned subsidiaries (the "Dillon Supermarkets"). The Dillon Supermarkets, principally located in Colorado, Kansas, Arizona and Missouri, operate under the names "King Soopers", "Dillon Food Stores", "Fry's Food Stores", "City Market", "Gerbes Supermarkets", and "Sav-Mor".

As of December 28, 1996, the Company, through its Dillon subsidiary, operated 831 convenience stores under the trade names of "Kwik Shop", "Quik Stop Markets", "Tom Thumb Food Stores", "Turkey Hill Minit Markets", "Loaf 'N Jug", and "Mini-Mart". The Company owned and operated 711 of these stores while 120 were operated through franchise agreements. The convenience stores offer a limited assortment of staple food items and general merchandise and, in most cases, sell gasoline.

The Company intends to develop new food and convenience store locations and will continue to assess existing stores as to possible replacement, remodeling, enlarging or closing.

SALES

Total sales for the fourth quarter of 1996 were $6.2 billion compared to $5.9 billion in the fourth quarter of 1995, a 5.8% increase. Sales for the full year increased 5.1%. Food stores sales for the fourth quarter 1996 were 5.0% ahead of the fourth quarter 1995 and 4.5% ahead for the year. A review of sales by lines of business for the three years ended December 28, 1996, is as follows:

	% of 1996 Sales	1996 Amount	1996 Change	1995 Amount	1995 Change	1994 Amount	1994 Change
		(millions of dollars)					
Food Stores	93.4%	$23,508	+4.5%	$22,488	+4.9%	$21,442	+4.9%
Convenience Stores	3.8%	948	+11.6%	850	−5.4%	898	−5.6%
Other sales	2.8%	714	+19.0%	600	−3.1%	619	−37.5%
Total sales	100.0%	$25,170	+5.1%	$23,938	+4.3%	$22,959	+2.6%

Sales in identical food stores, stores that have been in operation and have not been expanded or relocated for one full year, increased .5% in the fourth quarter and .5% for the full year. Identical store sales, excluding the strike in the King Soopers and City Markets divisions, were up 1.0% for the full year. In the fourth quarter comparable store sales, which include results of expanded and relocated stores, increased 4.0%. The increase in food stores' sales can be attributed primarily to inflation of less than .5%, the opening or expansion of 116 food stores, and higher average sales per customer. Higher sales per customer are the result of the Company's focus on the combination food and drug store, combining a food store with a pharmacy and numerous specialty departments such as floral, video rental, and book stores. The Company expects to emphasize this "one-stop shopping" convenience format tailored to each market to obtain future sales growth.

Convenience stores' sales increased 11.6% for the year and 15.4% during the fourth quarter of 1996. The convenience stores' sales increase can be attributed to a 12% increase in gas retails for the quarter on a 10.5% increase in gallons sold. In-store sales in identical convenience stores increased 1.9% for both the fourth quarter and the full year. Gasoline sales at identical convenience stores increased 13.3% in the fourth quarter 1996 on a 1.1% increase in gallons sold, and gasoline sales increased 8.9% for the year on a 1.5% increase in gallons sold.

Other sales primarily consists of outside sales by the Company's manufacturing divisions. The increase in other sales compared to 1995 was 24.2% for the fourth quarter and 19.0% for the year. Manufacturing division outside sales increased 22.5% in the fourth quarter 1996 and 15.4% for the full year.

Total food store square footage increased 6.7%, 4.6% and 4.7% in 1996, 1995, and 1994, respectively. The Company expects to increase retail food store square footage by approximately 5-6% in both 1997 and 1998. Convenience store square footage increased 1.5% in 1996, decreased 10.6% in 1995, and increased .4% in 1994.

Sales per average square foot for the last three years were:

	Total Sales Per Average Square Foot 1996	1995	1994
Food Stores	$403	$405	$404
Convenience Stores	$519	$475	$436

Sales per average square foot for convenience stores for 1996, 1995, and 1994 exclude stores that are operated by franchisees. The decrease in sales per average square foot for food stores can be attributed to a large increase in square footage at the end of 1996 as new store construction was completed.

The Company produced record sales in 1996 despite work stoppages at the King Soopers and City Markets divisions. In 1996 and 1995 sales improved despite increased competition from other food retailers, supercenters, mass merchandisers, and restaurants. The Company's wide regional diversity allowed it to withstand these challenges and to produce record results.

The sales improvement in 1994 was the result of new square footage combined with the increased productivity of existing stores.

The Company's future food store strategy is to invest in existing Kroger markets or adjacent geographic regions where the Company has a strong franchise and can leverage marketing, distribution, and overhead dollars. Consistent increases from the Company's existing store base combined with incremental contributions from the capital spending program are expected.

EBITD

The Company's Senior Competitive Advance and Revolving Credit Facility Agreement (the "Credit Agreement"), as amended, and the indentures underlying approximately $1.2 billion of publicly issued debt, contain various restrictive covenants, many of which are based on earnings before interest, taxes, depreciation, LIFO charge, unusual and extraordinary items ("EBITD"). All such covenants are based, among other things, upon generally accepted accounting principles ("GAAP") as applied on a date prior to January 3, 1993. The ability to generate EBITD at levels sufficient to satisfy the requirements of these agreements is a key measure of the Company's financial strength. The presentation of EBITD is not intended to be an alternative to any GAAP measure of performance but rather to facilitate an understanding of the Company's performance compared to its debt covenants. At December 28, 1996 the Company was in compliance with all covenants of its Credit Agreement. The Company believes it has adequate coverage of its debt covenants to continue to respond effectively to competitive conditions.

EBITD, which does not include the effect of Statement of Financial Accounting Standards ("SFAS") No. 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions," increased 6.7% in 1996 to $1.241 billion compared to $1.163 billion in 1995 and $1.065 billion in 1994. Excluding the effect of strikes in the King Soopers and City Markets divisions, EBITD would have been approximately $1.274 billion for 1996. EBITD growth was generated by sales gains, and reduced operating, general and administrative expenses as a percent of sales. The Company's strong storing program continued to produce incremental EBITD increases as well. EBITD increases in 1995 and 1994 were due in large part to increased sales combined with improved gross profits rates.

MERCHANDISE COSTS

Merchandise costs include warehousing and transportation expenses and LIFO charges or credits. The following table shows the relative effect that LIFO charges have had on merchandising costs as a percent of sales:

	1996	1995	1994
Merchandise costs as reported	75.65%	75.60%	75.81%
LIFO charge	.05%	.05%	.07%
Merchandise costs as adjusted	75.60%	75.55%	75.74%

On a consolidated basis, cost of goods increased for the year. However, the consolidated gross profit rate does not reflect the general trend in food stores. The food stores' gross profit rates were favorable to last year. Much of the decline in the consolidated gross profit rate was due to lower gross margins experienced at the convenience stores, primarily in gasoline. The Company will continue to invest capital in technology focusing on improved store operations, procurement, and distribution practices. Warehousing costs as a percent of sales declined from 1995's rates. The gross profit rate is expected to be favorably influenced by the Company's advances in consolidated distribution and coordinated purchasing, reduced transportation costs, and strong private label sales.

The Company expects to limit product cost increases through continued use of technology, outsourcing, and a variety of store level efficiency enhancements.

Operating, General and Administrative Expenses

Operating, general and administrative expenses as a percent of sales in 1996, 1995 and 1994 were 18.34%, 18.41% and 18.42%, respectively.

Operating, general and administrative costs declined 40 basis points in the fourth quarter and 7 basis points for the full year. The improved fourth quarter results were caused by a combination of factors, including favorable workers compensation and general liability trends, cost reduction achieved through enhanced technology, a reduction in employee benefit costs, and reduced administrative expenses.

The Company's goal for 1997 is to further reduce operating, general and administrative expense rates. Increased sales volume combined with investments in new technologies and logistics programs to improve efficiencies and lower costs while maintaining customer service, should help achieve this goal. In 1997, the Company plans to open or expand approximately 100 stores compared to 116 in 1996. This expansion program will adversely affect operating, general and administrative rates as upfront costs associated with the opening of new stores are incurred.

Income Taxes

The Company has closed all tax years through 1983 with the Internal Revenue Service. The Internal Revenue Service has completed its examination of the Company's tax returns for tax years 1984–1989. All issues have been resolved with one exception. Efforts to resolve this issue for tax years 1984–1986 with the Appeals Division of the Internal Revenue Service were unsuccessful. As a result the Company filed a petition with the United States Tax Court in Washington, D.C. Litigation was completed in November 1995 and a decision was rendered in January 1997 in favor of the Company. The Company is awaiting a decision from the Internal Revenue Service regarding appeal. This issue for years 1987–1989 is being held in abeyance pending the ultimate outcome of this court case. The Company has provided for this and other tax contingencies.

Net Earnings

Net earnings totaled $349.8 million in 1996 compared to $302.8 million in 1995 and $242.2 million in 1994. Earnings in 1996 compared to 1995 and 1994 were affected by: (i) an after tax extraordinary loss from the early retirement of debt in 1996 of $2.9 million compared to $16.1 million in 1995 and $26.7 million in 1994, (ii) net interest expense in 1996 of $300.0 million versus $312.7 million in 1995 and $327.6 million in 1994, and (iii) depreciation expense of $343.7 million, $311.3 million and $277.8 million in 1996, 1995 and 1994, respectively.

Liquidity and Capital Resources

Debt Management and Interest Expense

Net interest expense declined to $300.0 million in 1996 as compared to $312.7 million in 1995 and $327.6 million in 1994.

In 1996, the Company made open market purchases of $49.9 million of its senior and subordinated debt and redeemed $134.7 million of its subordinated debt. The repurchases and redemption were effected with proceeds from the issuance of $240 million of new senior debt, additional bank borrowings and cash generated from operations. In 1995 the Company repurchased, on the open market, $283.0 million of high yield senior and subordinated debt which was financed by cash generated from operations and lower cost bank debt. Interest expense was adversely affected in 1995 by an increase in market rates. In 1994 the Company repurchased or redeemed $559.5 million of high rate senior debt. A portion of these redemptions were financed by $111.4 million of new subordinated debt and $132.3 million in additional bank borrowings.

The Company has in place a Senior Competitive Advance and Revolving Credit Facility Agreement ("Credit Agreement") providing a $1.75 billion revolving credit loan through July 20, 2002. The average interest rate on the Company's bank debt, which totaled $1.001 billion at year-end 1996 versus $1.008 billion at year-end 1995 was 6.16% compared to 6.84% in 1995 and 5.57% in 1994. The Company's rate on the bank debt is variable.

The Company currently expects 1997 net interest expense, estimated using year-end 1996 rates, to total approximately $295 million. A 1% increase in market rates would increase this estimated expense by approximately $6.5 million. A 1% decrease in market rates would reduce the estimated expense by approximately $9.4 million.

Long-term debt, including capital leases and current portion thereof, increased $157.0 million to $3.681 billion at year-end 1996 from $3.524 billion at year-end 1995. The Company purchased a portion of the debt issued by the lenders of certain of its structured financings, which cannot be retired early, in an effort to effectively further reduce the Company's interest expense. Excluding the debt incurred to make these purchases, which are classified as investments, the Company's long-term debt would be $152.6 million less or $3.528 billion at year-end 1996 compared to $3.465 billion at year-end 1995.

Required principal repayments over the next five years amount to $285.8 million at year-end 1996 versus $429.2 million and $670.7 million at year-end 1995 and 1994, respectively. Scheduled debt maturities for the five years subsequent to 1996, 1995 and 1994 were:

	1996	1995	1994
		(in thousands)	
Year 1	$ 11,642	$ 24,939	$ 7,926
Year 2	16,095	11,838	14,341
Year 3	197,876	16,839	12,875
Year 4	28,868	337,419	15,507
Year 5	31,301	38,212	620,012

In 1996, Year 3 maturities include the remaining $124.7 million of 10% Senior Subordinated Notes.

In 1995, Year 4 maturities included the remaining $139.2 million of 10% Senior Subordinated Notes, and $125.0 million of 9% Senior Subordinated Notes.

In 1994, Year 5 maturities included $125 million of 9% Senior Subordinated Notes, $200 million of 6³⁄₈% Convertible Junior Subordinated Notes, and $222.6 million of 10% Senior Subordinated Notes. In 1995 the Company issued a redemption notice to the holders of the remaning outstanding balance of the 6³⁄₈% Convertible Junior Subordinated Notes. All of the holders elected to convert the notes into approximately 10.7 million shares of common stock.

Interest Rate Protection Program

The Company uses derivatives to limit its exposure to rising interest rates. The guidelines the Company follows are: (i) use average daily bank balance to determine annual debt amounts subject to interest rate exposure, (ii) limit the annual amount of debt subject to interest rate reset and the amount of floating rate debt to a combined total of $1 billion or less, (iii) include no leveraged products, and (iv) hedge without regard to profit motive or sensitivity to current mark-to-market status. The Company's compliance with these guidelines is reviewed semi-annually with the Financial Policy Committee of the Company's Board of Directors.

The Company currently has in place various interest rate hedging agreements with notional amounts aggregating $3.160 billion. The effect of these agreements is to: (i) fix the rate on $465 million floating rate debt, with $100 million of swaps expiring in December 1998, $125 million expiring in January 1999, $75 million expiring in January 2001, $65 million expiring in December 2004, and the remaining $100 million expiring in 2007, for which the Company pays an average rate of 6.72% and receives 6 month LIBOR; (ii) fix

the rate on $860 million floating rate debt incurred to purchase the Company's high-rate public bonds in the open market to match the original maturity of the debt purchased, with the Company borrowing at an effective rate that is lower than the yield to maturity of the repurchased debt and paying an average rate of 7.11% and receiving 6 month LIBOR on these agreements which will expire $375 million in 2000, $395 million in 2001, and $90 million in 2002; (iii) swap the contractual interest rate on $350 million of seven and ten year debt instruments into floating-rate instruments, for which the Company pays 6 month LIBOR and receives an average rate of 7.04%, with $100 million of these contracts expiring in May 1999 and the remaining $250 million expiring in August 2002, and concurrently, fixing the rate on $200 million of floating rate debt, with $100 million expiring in May 1997, and $100 million expiring in August 1998, for which the Company pays an average rate of 6.87%; effectively changing a portion of the Company's interest rate exposure from seven to ten years to three to five years; (iv) swap the contractual interest rate on $735 million of four, seven and ten year fixed-rate instruments into floating-rate instruments, for which the Company pays 6 month LIBOR and receives an average rate of 5.99%, with $75 million of these swaps expiring in February 1998, $75 million expiring in March 1998, $50 million expiring in October 1999, $100 million expiring in November 1999, $50 million expiring in July 2000, $110 million expiring in November 2000, $125 million expiring in January 2001, and $150 million expiring in July 2003; and (v) cap six month LIBOR on $550 million for one to five years at rates between 5.0% and 6.0%, with $50 million of the caps expiring in each of July 1997 and July 1998, $100 million expiring in December 1997, $100 million expiring in each of January 1997 and January 1998, and the remaining $150 million expiring in January 1999. Interest expense was increased $11,071 and $2,760 in 1996 and 1995, respectively, and reduced $13,449 in 1994, as a result of the Company's hedging program.

The Company's borrowings under the Credit Agreement are permitted to be in the form of commercial paper. At December 28, 1996, the Company had $187.7 million of commercial paper outstanding of the $1.001 billion in total bank borrowings. After deducting amounts set aside as backup for the Company's unrated commercial paper program, $739.5 million was available under the Company's Credit Agreement to meet short-term liquidity needs. There are no principal payments required under the Credit Agreement until its expiration on July 20, 2002.

Common Stock

On September 5, 1995 the Company issued approximately 10.7 million shares of common stock in connection with the redemption of its 6⅜% Convertible Junior Subordinated Notes and the election by holders to convert their Notes to stock.

Repurchase and Redemption of Debt

In 1996, the Company redeemed the entire $125 million outstanding balance of its 9% Senior Subordinated Notes and approximately $9.7 million of its General Term Notes, Series B. The Company also made open market purchases totaling $23.4 million of its 9¼% Senior Secured Debentures and $26.5 million of its various senior subordinated debt issues. Borrowings under the Credit Agreement, proceeds from exercise of stock options, the issuance of new senior debt, the sale of assets and excess cash from operations were used to finance these redemptions and repurchases. The outstanding balances of these debt issues at December 28, 1996 were $695.8 million for the senior subordinated debt issues which includes the General Term Notes, and $107.6 million for the 9¼% Senior Secured Debentures.

During 1995 the Company redeemed the remaining outstanding amount of its 6⅜% Convertible Junior Subordinated Notes. The holders elected thereupon to convert their Notes into 10.7 million shares of common stock. The Company also repurchased, on the open market, $29.1 million of its 9¼% Senior Secured Debentures and $253.9 million of its various senior subordinated debt issues. The redemptions and repurchases were affected using additional bank borrowings, cash from operations, proceeds from the sale of assets and working capital improvements. The outstanding balances of these debt issues at December 30, 1995 were $857.1 million for the senior subordinated debt issues and $131.0 million for the 9¼% Senior Secured Debentures.

During 1994 the Company redeemed the remaining outstanding amounts of its 11⅛% Senior Notes, its 8¾% Senior Subordinated Reset Notes and its 8¼% Convertible Junior Subordinated Debentures. The Company also repurchased $144.8 million of its various senior subordinated debt issues and $39.9 million of its 9¼% Senior Secured Debentures. The redemptions and repurchases were affected using funds from asset sales, the sale of treasury stock to employee benefit plans, proceeds from new financings, excess cash from operations and additional bank borrowings. The outstanding balances of these debt issues at December 31, 1994 were $1.105 billion for the Senior Subordinated Debt issues, and $160.2 million for the 9¼% Senior Secured Debentures.

Capital Expenditures

Capital expenditures totaled $733.8 million for 1996, compared to $726.1 million in 1995. Capital outlays in 1994 were $534.0 million. During 1996 the Company opened, acquired or expanded 116 food stores and 31 convenience stores compared to 83 food stores and 19 convenience stores in 1995 and 82 food stores and 17 convenience stores in 1994. The Company also completed 53 food store and 9 convenience store remodels during 1996. During 1996, the Company closed or sold 49 food stores and 19 convenience stores.

The Company expects 1997 capital expenditures, including additional Company owned real estate, logistics projects, and continuing technology investments, to total approximately $800-$850 million. Food store square footage is expected to increase 5-6% through the opening, expansion or acquisition of approximately 90-100 food stores. The Company also expects to complete within-the-wall remodels of 50 food stores. The increased square footage is planned for existing Company markets where the Company has an established market position and an existing administrative and logistical network. The Company's ability to execute its capital expenditure plan will depend, in part, on its ability to generate continued EBITD growth.

Consolidated Statement of Cash Flows

During 1996 the Company generated $477.8 million in cash from operating activities compared to $798.5 million in 1995 and $750.3 million in 1994. The decrease from 1995 is primarily due to an increase in operating assets and liabilities that used $248.5 million of cash in 1996 compared to generating cash of $143.0 million in 1995. The largest component of the change in operating assets and liabilities was net owned inventories due in part to the Company's storing program and warehouse expansions which increased $224.5 million as compared to a decrease of $109.1 million in 1995. Additionally, prepaid and other assets increased $120.6 million, primarily because of the Company's funding of a Voluntary Employee Benefit Association Trust for employee benefit plan expenses. Offsetting these net uses of cash were increases in net earnings before extraordinary losses of $47.1 million and non-cash charges for depreciation and amortization of $32.5 million.

Investing activities used $856.9 million compared to $665.6 million of cash used in 1995 and $546.5 million of cash used in 1994. The increase in the use of cash was due to increased purchase of investments of $140.9 million and increased capital expenditures of $7.7 million combined with a decrease in proceeds from sale of assets and investments of $40.3 million.

Cash provided by financing activities in 1996 totaled $379.1 million compared to uses of $160.2 million and $297.8 million in 1995 and 1994, respectively. The decrease in the use of cash during 1996 as compared to 1995 is due to a 1996 net debt increase of $146.9 million versus 1995's net debt reduction of $191.0 million. Additionally, $6.8 million less cash was needed for debt prepayments and finance charges and an additional $175.4 million was provided by outstanding checks. An additional $19.5 million was provided from the sale of stock and related transactions.

Other Issues

The Company is party to more than 200 collective bargaining agreements with local unions representing approximately 160,000 of the Company's employees. During 1996 the Company negotiated over 50 labor contracts, but it did incur work stoppages in the King Soopers and City Markets divisions. Typical agreements are 3 to 5 years in duration, and as such agreements expire, the Company expects to negotiate with the unions and to enter into new collective bargaining agreements. There can be no assurance, however, that such agreements will be reached without work stoppage. A prolonged work stoppage affecting a substantial number of stores could have a material adverse effect on the results of the Company's operations. Major union contracts that will be negotiated in 1997 include Phoenix, Dallas, Atlanta and Nashville store employees.

Subsequent Events

On January 29, 1997, the Company announced that it would begin a stock repurchase program in order to reduce dilution caused by the Company's stock option plans for employees. The repurchase program will be funded by proceeds derived from employee stock option exercises, plus associated tax benefits.

Effective as of February 15, 1997, the Company redeemed the entire outstanding balances of its 9¾% Senior Subordinated Debentures and its 9¾% Senior Subordinated Debentures, Series B, both of which were due in 2004. The balance outstanding under both issues totaled approximately $142 million.

Special Note

The foregoing Management's Discussion and Analysis contains certain forward-looking statements about the future performance of the Company which are based on management's assumptions and beliefs in light of the information currently available to it. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from those statements including, but not limited to: competitive practices and pricing in the food and drug industries generally and particularly in the Company's principal markets; changes in the financial markets related to the cost of the Company's capital; the ability of the Company to access the public debt and equity markets to refinance indebtedness and fund the Company's capital expenditure program on satisfactory terms; supply or quality control problems with the Company's vendors; labor disputes and material shortages; and changes in economic conditions that affect the buying patterns of the Company's customers.

Report of Independent Accountants

To the Shareowners and Board of Directors
The Kroger Co.

We have audited the accompanying consolidated balance sheet of The Kroger Co. as of December 28, 1996 and December 30, 1995, and the related consolidated statements of operations and accumulated deficit, and cash flows for the years ended December 28, 1996, December 30, 1995, and December 31, 1994. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Kroger Co. as of December 28, 1996 and December 30, 1995, and the consolidated results of its operations and its cash flows for the years ended December 28, 1996, December 30, 1995, and December 31, 1994, in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.
Cincinnati, Ohio
January 22, 1997

CONSOLIDATED BALANCE SHEET

(In thousands of dollars)	December 28, 1996	December 30, 1995
ASSETS		
Current assets		
Receivables	$ 324,050	$ 288,067
Inventories:		
FIFO cost	2,175,630	2,034,880
Less LIFO reserve	(461,689)	(449,163)
	1,713,941	1,585,717
Property held for sale	38,333	40,527
Prepaid and other current assets	276,440	192,673
Total current assets	2,352,764	2,106,984
Property, plant and equipment, net	3,063,534	2,662,338
Investments and other assets	409,115	275,395
Total Assets	$ 5,825,413	$ 5,044,717
LIABILITIES		
Current liabilities		
Current portion of long-term debt	$ 11,642	$ 24,939
Current portion of obligations under capital leases	9,501	8,975
Accounts payable	1,650,256	1,540,067
Other current liabilities	1,041,521	991,456
Total current liabilities	2,712,920	2,565,437
Long-term debt	3,478,743	3,318,499
Obligations under capital leases	180,748	171,229
Deferred income taxes	151,036	153,232
Other long-term liabilities	483,672	439,333
Total Liabilities	7,007,119	6,647,730
SHAREOWNERS' DEFICIT		
Common capital stock, par $1		
Authorized: 350,000,000 shares		
Issued: 1996—136,461,521 shares		
1995—133,777,921 shares	658,230	586,541
Accumulated deficit	(1,596,050)	(1,945,923)
Common stock in treasury, at cost		
1996—9,581,856 shares		
1995—9,575,950 shares	(243,886)	(243,631)
Total Shareowners' Deficit	(1,181,706)	(1,603,013)
Total Liabilities and Shareowners' Deficit	$ 5,825,413	$ 5,044,717

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Operations and Accumulated Deficit

Years Ended December 28, 1996, December 30, 1995 and December 31, 1994

(In thousands, except per share amounts)	1996 (52 Weeks)	1995 (52 Weeks)	1994 (52 Weeks)
Sales	$25,170,909	$23,937,795	$22,959,122
Costs and expenses			
Merchandise costs, including warehousing and transportation	19,041,465	18,098,027	17,404,940
Operating, general and administrative	4,616,749	4,406,445	4,228,046
Rent	301,629	299,828	299,473
Depreciation and amortization	343,769	311,272	277,750
Net interest expense	299,984	312,685	327,550
Total	24,603,596	23,428,257	22,537,759
Earnings before tax expense and extraordinary loss	567,313	509,538	421,363
Tax expense	214,578	190,672	152,460
Earnings before extraordinary loss	352,735	318,866	268,903
Extraordinary loss, net of income tax benefit	(2,862)	(16,053)	(26,707)
Net earnings	$ 349,873	$ 302,813	$ 242,196
Accumulated Deficit			
Beginning of year	$(1,945,923)	$(2,248,736)	$(2,490,932)
Net earnings	349,873	302,813	242,196
End of year	$(1,596,050)	$(1,945,923)	$(2,248,736)
Primary earnings per Common Share			
Earnings before extraordinary loss	$ 2.68	$ 2.65	$ 2.37
Extraordinary loss	(.02)	(.13)	(.24)
Net earnings	$ 2.66	$ 2.52	$ 2.13
Average number of common shares used in primary calculation	131,375	120,413	113,537
Fully-diluted earnings per Common Share			
Earnings before extraordinary loss	$ 2.67	$ 2.50	$ 2.19
Extraordinary loss	(.02)	(.12)	(.21)
Net earnings	$ 2.65	$ 2.38	$ 1.98
Average number of common shares used in fully-diluted calculation	132,033	129,232	129,714

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Cash Flows

Years Ended December 28, 1996, December 30, 1995, and December 31, 1994

(In thousands of dollars)	1996 (52 Weeks)	1995 (52 Weeks)	1994 (52 Weeks)
Cash Flows From Operating Activities:			
Net earnings	$ 349,873	$ 302,813	$ 242,196
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Extraordinary loss	2,862	16,053	26,707
Depreciation and amortization	343,769	311,272	277,750
Amortization of deferred financing costs	13,004	13,189	15,305
Gain on sale of investment			(25,099)
Loss (gain) on sale of assets	4,496	(710)	(3,672)
LIFO charge	12,526	14,103	16,087
Non-cash contribution			4,364
Other changes, net	(200)	(1,176)	694
Net increase in cash from changes in operating assets and liabilities, net of effects from sale of subsidiary, detailed hereafter	(248,528)	143,002	195,931
Net cash provided by operating activities	477,802	798,546	750,263
Cash Flows From Investing Activities:			
Capital expenditures	(733,883)	(726,142)	(533,965)
Proceeds from sale of assets	9,242	49,530	21,819
(Increase) decrease in property held for sale	580	2,942	(19,694)
(Increase) decrease in other investments	(132,796)	8,106	(65,124)
Proceeds from sale of investment			50,469
Net cash used by investing activities	(856,857)	(665,564)	(546,495)
Cash Flows From Financing Activities:			
Debt prepayment costs	(4,196)	(22,244)	(24,696)
Financing charges incurred	(17,927)	(6,716)	(22,868)
Principal payments under capital lease obligations	(9,229)	(8,780)	(8,249)
Proceeds from issuance of long-term debt	382,161	113,246	902,979
Reductions in long-term debt	(235,214)	(304,234)	(1,207,125)
Outstanding checks	193,997	18,633	
Proceeds from issuance of capital stock	48,120	38,451	24,753
Proceeds from sale of treasury stock		151	30,609
Capital stock reacquired	(254)	(217)	(257)
Tax benefit of non-qualified stock options	21,597	11,505	7,056
Net cash provided (used) by financing activities	379,055	(160,205)	(297,798)
Net decrease in cash and temporary cash investments	0	(27,223)	(94,030)
Cash and Temporary Cash Investments:			
Beginning of year	0	27,223	121,253
End of year	$ 0	$ 0	$ 27,223

CONSOLIDATED STATEMENT OF CASH FLOWS, CONTINUED

Years Ended December 28, 1996, December 30, 1995, and December 31, 1994

(In thousands of dollars)	1996 (52 Weeks)	1995 (52 Weeks)	1994 (52 Weeks)
Increase (Decrease) In Cash From Changes In Operating Assets And Liabilities:			
Inventories (FIFO)	**$(140,750)**	$ 10,396	$(51,831)
Receivables	**(35,983)**	(18,207)	17,114
Prepaid and other current assets	**(120,641)**	(3,992)	(5,749)
Accounts payable	**(83,808)**	98,681	68,080
Accrued expenses	**76,423**	43,501	110,290
Deferred income taxes	**45,665**	(10,008)	(4,170)
Other liabilities	**10,566**	22,631	62,197
	$(248,528)	$143,002	$195,931

The accompanying notes are an integral part of the consolidated financial statements.

All dollar amounts are in thousands except per share amounts.

ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed in preparing these financial statements:

Principles of Consolidation

The consolidated financial statements include the Company and all of its subsidiaries.

Pervasiveness of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of consolidated revenues and expenses during the reporting period. Actual results could differ from those estimates.

Segments of Business

The Company operates primarily in one business segment—retail food and drug stores, predominately in the Midwest and South as well as Colorado, Arizona, and Kansas. This segment represents more than 90% of consolidated revenue, operating profit and identifiable assets. The Company also manufactures and processes food for sale by its supermarkets and others and operates convenience stores.

Inventories

Inventories are stated at the lower of cost (principally LIFO) or market. Approximately 88% of inventories for 1996 and 87% of inventories for 1995 were valued using the LIFO method. Cost for the balance of the inventories is determined using the FIFO method.

Property Held for Sale

Property held for sale includes the net book value of property, plant and equipment that the Company plans to sell. The property is valued at the lower of cost or market on an individual property basis.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization, which includes the amortization of assets recorded under capital leases, are computed principally using the straight-line method over the estimated useful lives of individual assets, composite group lives or the initial or remaining terms of leases. Buildings and land improvements are depreciated based on lives varying from ten to 40 years and equipment depreciation is based on lives varying from three to 15 years. Leasehold improvements are amortized over their useful lives which vary from four to 25 years.

Interest Rate Protection Agreements

The Company uses interest rate swaps and caps to hedge a portion of its borrowings against changes in interest rates. The interest differential to be paid or received is accrued as interest rates change and is recognized over the life of the agreements currently as a component of interest expense. Gains and losses from the disposition of hedge agreements are deferred and amortized over the term of the related agreements.

Advertising Costs

The Company's advertising costs are predominately expensed as incurred and included in "operating, general and administrative expenses." Advertising expenses amounted to $302 million, $281 million and $250 million for 1996, 1995 and 1994, respectively.

Deferred Income Taxes

Deferred income taxes are recorded to reflect the tax consequences on future years of differences between the tax bases of assets and liabilities and their financial reporting bases. The types of differences that

give rise to significant portions of deferred income tax liabilities or assets relate to: property, plant and equipment, inventories and other charges, and accruals for compensation-related costs. Deferred income taxes are classified as a net current and noncurrent asset or liability based on the classification of the related asset or liability for financial reporting. A deferred tax asset or liability that is not related to an asset or liability for financial reporting is classified according to the expected reversal date. (See Taxes Based on Income footnote.)

Consolidated Statement of Cash Flows

For purposes of the Consolidated Statement of Cash Flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be temporary cash investments. Outstanding checks represent disbursements which are funded as the item is presented for payment.

Cash paid during the year for interest and income taxes was as follows:

	1996	1995	1994
Interest	$304,240	$322,411	$329,570
Income taxes	166,732	175,151	131,156

PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consists of:

	1996	1995
Land	$ 308,451	$ 231,624
Buildings and land improvements	1,034,441	792,089
Equipment	2,895,826	2,609,915
Leaseholds and leasehold improvements	807,422	763,381
Construction-in-progress	417,080	492,750
Leased property under capital leases	263,398	254,897
	5,726,618	5,144,656
Accumulated depreciation and amortization	(2,663,084)	(2,482,318)
	$ 3,063,534	$ 2,662,338

Approximately $723,961, original cost, of Property, Plant and Equipment collateralizes certain mortgage obligations.

INVESTMENTS AND OTHER ASSETS

Investments and other assets consists of:

	1996	1995
Deferred financing costs	$ 90,171	$ 85,417
Goodwill	39,745	43,253
Investments in Debt Securities	152,675	58,988
Other	126,524	87,737
	$409,115	$275,395

The Company is amortizing deferred financing costs using the interest method. Substantially all goodwill is amortized on the straight-line method over 40 years. Investments in Debt Securities are held at their amortized cost and the Company intends to hold them to maturity.

OTHER CHARGES AND CREDITS

During 1994 the Company recorded a $25,100 pre-tax charge to recognize future lease commitments and losses on equipment in certain San Antonio stores sublet to Megafoods, Inc. which declared bankruptcy during 1994. The Company had sold its San Antonio stores to Megafoods in 1993. Also during 1994 the Company recorded a gain of $25,100 on the disposition of its investment in Hook-Superx, Inc. ("HSI"), as a part of the merger of HSI and a subsidiary of Revco D.S., after providing for certain tax indemnities related to HSI.

In 1994 the Company donated a portion of its stock investment in HSI, with a $4,364 pre-tax book value, to The Kroger Co. Foundation. The donation resulted in a $2,705 after tax expense ($.02 per fully diluted share) and produced a $5,942 tax benefit ($.04 per fully diluted share).

OTHER CURRENT LIABILITIES

Other current liabilities consists of:

	1996	1995
Salaries and wages	$ 292,393	$286,058
Taxes, other than income taxes	146,781	152,006
Interest	39,202	39,993
Other	563,145	513,399
	$1,041,521	$991,456

TAXES BASED ON INCOME

The provision for taxes based on income consists of:

	1996	1995	1994
Federal			
Current	$146,296	$178,936	$127,393
Deferred	43,638	(10,008)	2,184
	189,934	168,928	129,577
State and local	24,644	21,744	22,883
	214,578	190,672	152,460
Tax credit from extraordinary loss	(1,792)	(10,263)	(17,075)
	$212,786	$180,409	$135,385

Targeted job tax credits reduced the tax provision by $1,206 in 1995, and $3,240 in 1994.

A reconciliation of the statutory federal rate and the effective rate is as follows:

	1996	1995	1994
Statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	2.8	2.8	3.5
Tax credits	(.2)	(.4)	(1.2)
Other, net	.2		(1.1)
	37.8%	37.4%	36.2%

The tax effects of significant temporary differences and carryforwards that comprise deferred tax balances were as follows:

	1996	1995
Current deferred tax assets:		
Compensation related costs	$ 27,873	$ 25,983
Insurance related costs	33,109	32,131
Inventory related costs	19,092	19,045
Other	19,844	25,076
	99,918	102,235
Current deferred tax liabilities:		
Compensation related costs	(63,691)	(24,669)
Lease accounting	(3,680)	(4,180)
Inventory related costs	(33,116)	(27,585)
Other	(8,582)	(9,118)
	(109,069)	(65,552)
Current deferred taxes, net	$ (9,151)	$ 36,683
Long-term deferred tax assets:		
Compensation related costs	$ 125,466	$ 118,255
Insurance related costs	43,492	40,956
Lease accounting	24,214	23,748
Other	15,466	8,293
	208,638	191,252
Long-term deferred tax liabilities:		
Depreciation	(312,546)	(295,303)
Compensation related costs	(14,239)	(14,100)
Lease accounting	(1,863)	(5,845)
Deferred charges	(7,471)	(7,979)
Other	(23,555)	(21,257)
	(359,674)	(344,484)
Long-term deferred taxes, net	$(151,036)	$(153,232)

DEBT OBLIGATIONS

Long-term debt consists of:

	1996	1995
Variable Rate Revolving Credit Facility, due 2002	$1,001,459	$1,008,128
Credit Facility	110,000	
9¼% Senior Secured Debentures, due 2005	107,648	131,011
8½% Senior Secured Debentures, due 2003	200,000	200,000
8.15% Senior Notes due 2006	240,000	
9% Senior Subordinated Notes, due 1999		125,000
9¾% Senior Subordinated Debentures, due 2004	96,008	102,419
9¾% Senior Subordinated Debentures, due 2004, Series B	46,050	48,051
9⅞% Senior Subordinated Debentures, due 2002	83,065	86,658
6¾% to 9⅝% Senior Subordinated Notes, due 1999 to 2009	346,064	355,774
10% Senior Subordinated Notes, due 1999	124,703	139,244
10% Mortgage loans, with semi-annual payments due through 2004	605,665	606,982
4⁹⁄₁₀% to 8⅝% Industrial Revenue Bonds, due in varying amounts through 2021	203,785	205,035
7⅞% to 10¼% mortgages, due in varying amounts through 2017	280,711	297,313
3½% to 10¼% notes, due in varying amounts through 2017	45,227	37,823
Total debt	3,490,385	3,343,438
Less current portion	11,642	24,939
Total long-term debt	$3,478,743	$3,318,499

The aggregate annual maturities and scheduled payments of long-term debt for the five years subsequent to 1996 are:

1997	$ 11,642
1998	$ 16,095
1999	$197,876
2000	$ 28,868
2001	$ 31,301

The Company has purchased a portion of the debt issued by the lenders of certain of its structured financings, which cannot be retired early, in an effort to effectively further reduce the Company's interest expense. Excluding the debt incurred to make these purchases, which are classified as investments, the Company's total debt would be $152,675 less or $3,337,710 at year-end 1996 compared to $3,284,450 at year-end 1995.

Variable Rate Revolving Credit Facility

The Company has outstanding a Senior Competitive Advance and Revolving Credit Facility Agreement, dated as of July 19, 1994, as amended, (the "Credit Agreement"). The following constitutes only a summary of the principal terms and conditions of the Credit Agreement. Reference is directed to the Credit Agreement attached as an exhibit to the Company's Current Report on Form 8-K dated July 20, 1994.

The Credit Agreement provides for a $1,750,000 Senior Competitive Advance and Revolving Credit Facility (the "Facility"), which expires on July 20, 2002, and is not otherwise subject to amortization.

Interest Rates

Borrowings under the Facility bear interest at the option of the Company at a rate equal to either (i) the highest, from time to time, of (A) the average of the publicly announced prime rate of Chemical Bank and Citibank, N.A., (B) ½% over a moving average of secondary market morning offering rates for three month

certificates of deposit adjusted for reserve requirements, and (C) ½% over the federal funds rate or (ii) an adjusted Eurodollar rate based upon the London Interbank Offered Rate ("Eurodollar Rate") plus the Applicable Percentage which varies from .125% to .5% based upon the Company's achievement of a financial ratio. At December 28, 1996, the Applicable Percentage was .225% for Eurodollar Rate advances. The Company also pays a facility fee ("Facility Fee") based on the entire $1,750,000 Facility which varies from .125% to .25% based upon the Company's achievement of a financial ratio. The Facility Fee at December 28, 1996 was .15%.

Collateral

The Company's obligations under the Facility originally were collateralized by a pledge of a substantial portion of the Company's and certain of its Subsidiaries' assets, including substantially all of the Company's and such Subsidiaries' inventory and equipment and the stock of all Subsidiaries, which collateral also secured the Company's obligations under its Secured Debentures. On April 29, 1996, pursuant to the terms of the Credit Agreement, the Company elected to release all collateral.

Prepayment

The Company may prepay the Facility, in whole or in part, at any time, without a prepayment penalty.

Certain Covenants

The Credit Agreement contains covenants which, among other things, (i) restrict investments, capital expenditures, and other material outlays and commitments relating thereto; (ii) restrict the incurrence of debt, including the incurrence of debt by subsidiaries; (iii) restrict dividends and payments, prepayments, and repurchases of capital stock; (iv) restrict mergers and acquisitions and changes of business or conduct of business; (v) restrict transactions with affiliates; (vi) restrict certain sales of assets; (vii) restrict changes in accounting treatment and reporting practices except as permitted under generally accepted accounting principles; (viii) require the maintenance of certain financial ratios and levels, including fixed charge coverage ratios, senior debt ratios and total debt ratios; and (ix) require the Company to maintain interest rate protection providing that at least 50% of the Company's indebtedness for borrowed money is maintained at a fixed rate of interest.

Credit Facility

Effective December 13, 1996, the Company entered into a $110,000 financing ("VEBA Financing") to fund the cost of providing certain employee benefits. The following constitutes only a summary of the principal terms and conditions of the financing. Reference is made to the credit agreement related to the VEBA Financing attached as an exhibit to the Company's Current Report on Form 8-K dated December 26, 1996.

The VEBA Financing provides for an initial term of 364 days. The Company annually may request a 364 day extension, subject to approval of the lenders. The Company currently intends to request, on an annual basis, that the lenders grant such an extension. Should the lenders decline the extension request, the Company expects to refinance the VEBA Financing with funds available under the Credit Agreement. The Company has classified this financing as long-term with a maturity equal to the Credit Agreement.

The VEBA Financing is a variable rate facility with a current borrowing rate of LIBOR plus 20 basis points, in addition to a facility fee of 9 basis points. The VEBA Financing includes various covenants, none of which, individually or in the aggregate, are more restrictive than those contained in the Credit Agreement.

9¼% Senior Secured Debentures

On January 25, 1993, the Company issued $200,000 of 9¼% Senior Secured Debentures (the "9¼% Senior Secureds"). As of December 28, 1996, the Company has repurchased $92,352 of this issue, $23,363 of these repurchases were completed in 1996. The 9¼% Senior Secureds become due on January 1, 2005. The 9¼% Senior Secureds are redeemable at any time on or after January 1, 1998, in whole or in part at the option of the Company. The redemption prices commence at 104.625% and are reduced by 1.156% annually until

January 1, 2002 when the redemption price is 100%. These debentures were originally secured. On April 29, 1996, all collateral was released pursuant to the terms of the indenture.

8½% Senior Secured Debentures

On July 1, 1993, the Company issued $200,000 of 8½% Senior Secured Debentures (the "8½% Senior Secureds"). The 8½% Senior Secureds become due on June 15, 2003. The 8½% Senior Secureds are redeemable at any time on or after June 15, 1998, in whole or in part at the option of the Company. The redemption prices commence at 104.250% and are reduced by 1.4165% annually until June 15, 2001, when the redemption price is 100%. These debentures were originally secured. On April 29, 1996, all collateral was released pursuant to the terms of the indenture.

8.15% Senior Notes

On July 24, 1996, the Company issued $240,000 of 8.15% Senior Notes (the "8.15% Senior Notes"). The 8.15% Senior Notes become due on July 15, 2006 and are not redeemable prior to their final maturity.

9% Senior Subordinated Notes

The 9% Senior Subordinated Notes were redeemed on August 14, 1996.

Senior Subordinated Indebtedness

Senior Subordinated Indebtedness consists of the following: (i) $175,000 9¾% Senior Subordinated Debentures due February 15, 2004, redeemable at any time on or after February 15, 1997 in whole or in part at the option of the Company, commencing at 104.875% in 1997 and reduced by 1.625% annually until 2000 when the redemption price is 100% (of the total $78,992 repurchased by the Company, $6,411 was repurchased in 1996); (ii) $100,000 9¾% Senior Subordinated Debentures due February 15, 2004, Series B, redeemable at any time on or after February 15, 1997 in whole or in part at the option of the Company, commencing at 104.875% in 1997 and reduced by 1.625% annually until 2000 when the redemption price is 100% (the Company has repurchased $53,950 of the 9¾% Senior Subordinated Debentures, Series B. $2,001 of these purchases occurred in 1996); (iii) $250,000 9⅞% Senior Subordinated Debentures due August 1, 2002, redeemable at any time on or after August 1, 1999, in whole or in part at the option of the Company at par (the Company has repurchased $166,935 of the 9⅞% Senior Subordinated Debentures, $3,593 in 1996); (iv) $355,774 6¾% to 9⅝% Senior Subordinated Notes due March 15, 1999 to October 15, 2009, with portions of these issues subject to early redemption by the Company at varying times and premiums (the Company repurchased $9,710 of the notes in 1996); (v) $250,000 10% Senior Subordinated Notes due May 1, 1999. This issue is not subject to early redemption by the Company. The Company repurchased $14,541 of the 10% Senior Subordinated Notes during 1996. A total of $125,297 of this issue has been repurchased.

Redemption Event

Subject to certain conditions (including repayment in full of all obligations under the Credit Agreement or obtaining the requisite consents under the Credit Agreement), the Company's publicly issued debt will be subject to redemption, in whole or in part, at the option of the holder upon the occurrence of a redemption event, upon not less than five days' notice prior to the date of redemption, at a redemption price equal to the default amount, plus a specified premium. "Redemption Event" is defined in the indentures as the occurrence of (i) any person or group, together with any affiliate thereof, beneficially owning 50% or more of the voting power of the Company or (ii) any one person or group, or affiliate thereof, succeeding in having a majority of its nominees elected to the Company's Board of Directors, in each case, without the consent of a majority of the continuing directors of the Company.

Mortgage Financing

During 1989 the Company completed a $612,475, 10% mortgage financing of 127 of its retail properties, distribution warehouse facilities, food processing facilities and other properties (the "Properties"), with a net book value of $325,327 held by 13 newly formed wholly-owned subsidiaries. The wholly-owned

subsidiaries mortgaged the Properties, which are leased to the Company or affiliates of the Company, to a newly formed special purpose corporation, Secured Finance Inc.

The mortgage loans had an original maturity of 15 years. The Properties are subject to the liens of Secured Finance Inc. The mortgage loans are subject to semi-annual payments of interest and principal on $150,000 of the borrowing based on a 30-year payment schedule and interest only on the remaining $462,475 principal amount. The unpaid principal amount will be due on December 15, 2004.

Commercial Paper

Under the Credit Agreement the Company is permitted to issue up to $1,750,000 of unrated commercial paper and borrow up to $1,750,000 from the lenders under the Credit Agreement on a competitive bid basis. The total of unrated commercial paper, $196,000 at December 28, 1996, and competitive bid borrowings, $251,500 at December 28, 1996, however, may not exceed $1,750,000. All commercial paper and competitive bid borrowings must be supported by availability under the Credit Agreement. These borrowings have been classified as long-term because the Company expects that during 1997 these borrowings will be refinanced using the same type of securities. Additionally, the Company has the ability to refinance the short-term borrowings under the Facility which matures July 20, 2002.

Interest Rate Protection Program

The Company uses derivatives to limit its exposure to rising interest rates. The guidelines the Company follows are: (i) use average daily bank balance to determine annual debt amounts subject to interest rate exposure, (ii) limit the annual amount of debt subject to interest rate reset and the amount of floating rate debt to a combined total of $1,000,000 or less, (iii) include no leveraged products, and (iv) hedge without regard to profit motive or sensitivity to current mark-to-market status. The Company's compliance with these guidelines is reviewed semi-annually with the Financial Policy Committee of the Company's Board of Directors.

The Company currently has in place various interest rate hedging agreements with notional amounts aggregating $3,160,000. The effect of these agreements is to: (i) fix the rate on $465,000 floating rate debt, with $100,000 of swaps expiring in December 1998, $125,000 expiring in January 1999, $75,000 expiring in January 2001, $65,000 expiring in December 2004, and the remaining $100,000 expiring in 2007, for which the Company pays an average rate of 6.72% and receives 6 month LIBOR; (ii) fix the rate on $860,000 floating rate debt incurred to purchase the Company's high-rate public bonds in the open market to match the original maturity of the debt purchased, with the Company borrowing at an effective rate that is lower than the yield to maturity of the repurchased debt and paying an average rate of 7.11% and receiving 6 month LIBOR on these agreements which will expire $375,000 in 2000, $395,000 in 2001, and $90,000 in 2002; (iii) swap the contractual interest rate on $350,000 of seven and ten year debt instruments into floating-rate instruments, for which the Company pays 6 month LIBOR and receives an average rate of 7.04%, with $100,000 of these contracts expiring in May 1999 and the remaining $250,000 expiring in August 2002, and concurrently, fixing the rate on $200,000 of floating rate debt, with $100,000 expiring in May 1997, and $100,000 expiring in August 1998, for which the Company pays an average rate of 6.87%; effectively changing a portion of the Company's interest rate exposure from seven to ten years to three to five years; (iv) swap the contractual interest rate on $735,000 of four, seven and ten year fixed-rate instruments into floating-rate instruments, for which the Company pays 6 month LIBOR and receives an average rate of 5.99%, with $75,000 of these swaps expiring in February 1998, $75,000 expiring in March 1998, $50,000 expiring in October 1999, $100,000 expiring in November 1999, $50,000 expiring in July 2000, $110,000 expiring in November 2000, $125,000 expiring in January 2001, and $150,000 expiring in July 2003; and (v) cap six month LIBOR on $550,000 for one to five years at rates between 5.0% and 6.0%, with $50,000 of the caps expiring in each of July 1997 and July 1998, $100,000 expiring in December 1997, $100,000 expiring in each of January 1997 and January 1998, and the remaining $150,000 expiring in January 1999. Interest expense was increased $11,071 and $2,760 in 1996 and 1995, respectively, and reduced $13,449 in 1994, as a result of the Company's hedging program.

The present value of the estimated annual effect on future interest expense of the Company's derivative portfolio, based on six month LIBOR of 5.63% as in effect at year-end and the forward yield curve at year-end is:

	Year-End LIBOR at 5.63%	Forward Yield Curve	
	Income (Expense)		LIBOR Rate
1997	$ (8,113)	$ (7,775)	5.88%
1998	(7,910)	(6,958)	6.17%
1999	(7,700)	(6,536)	6.97%
2000	(6,585)	(5,929)	6.59%
2001	(1,653)	(1,934)	6.73%
2002	1,038	(658)	6.85%
2003	(310)	(430)	6.94%
2004	(469)	80	7.02%
	$(31,702)	$(30,140)	

(See Fair Value of Financial Instruments footnote.)

FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Long-term Investments

The fair values of these investments are estimated based on quoted market prices for those or similar investments.

Long-term Debt

The fair value of the Company's long-term debt, including the current portion thereof, is estimated based on the quoted market price for the same or similar issues.

Interest Rate Protection Agreements

The fair value of these agreements is based on the net present value of the future cash flows using the forward interest rate yield curve in effect at the respective years-end. If the swaps and caps were cancelled as of the respective years-end the result would have been a net cash outflow for 1996 and 1995. The swaps and caps are linked to the Company's debt portfolio. (See Accounting Policies and Debt Obligations footnotes.)

The estimated fair values of the Company's financial instruments are as follows:

	1996		1995	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Long-term investments for which it is				
Practicable	$ 154,748	$ 154,645	$ 53,423	$ 53,423
Not Practicable	$ 31,576	$ —	$ 29,508	$ —
Long-term debt for which it is				
Practicable	$1,849,203	$1,980,925	$1,795,139	$1,942,414
Not Practicable	$1,641,182	$ —	$1,548,299	$ —
Interest Rate Protection Agreements				
Variable rate pay swaps	$ —	$ 4,900	$ —	$ 30,595
Fixed rate pay swaps	$ —	$ (37,311)	$ —	$ (56,120)
Interest rate caps	$ 3,854	$ 2,807	$ 6,773	$ 3,378
	$ 3,854	$ (29,604)	$ 6,773	$ (22,147)

The investments for which it was not practicable to estimate fair value relate to equity investments accounted for under the equity method and investments in real estate development partnerships for which there is no market.

It was not practicable to estimate the fair value of $1,001,459 of long-term debt outstanding under the Company's Credit Agreement. There is no liquid market for this debt. The remaining long-term debt that it was not practicable to estimate relates to Industrial Revenue Bonds of $203,785, various mortgages of $280,711, and other notes of $155,227 for which there is no market.

LEASES

The Company operates primarily in leased facilities. Lease terms generally range from 10 to 25 years with options to renew at varying terms. Certain of the leases provide for contingent payments based upon a percent of sales.

Rent expense (under operating leases) consists of:

	1996	1995	1994
Minimum rentals	$291,256	$288,961	$288,499
Contingent payments	10,373	10,867	10,974
	$301,629	$299,828	$299,473

Assets recorded under capital leases consists of:

	1996	1995
Distribution and manufacturing facilities	$ 30,381	$ 35,382
Store facilities	233,017	219,515
Less accumulated amortization	(118,589)	(118,482)
	$ 144,809	$ 136,415

Minimum annual rentals for the five years subsequent to 1996 and in the aggregate are:

	Capital Leases	Operating Leases
1997	$ 31,974	$ 293,302
1998	31,332	280,191
1999	31,042	265,751
2000	30,099	246,444
2001	29,041	225,502
Thereafter	245,364	1,955,358
	398,852	$3,266,548
Less estimated executory costs included in capital leases	20,606	
Net minimum lease payments under capital leases	378,246	
Less amount representing interest	187,997	
Present value of net minimum lease payments under capital leases	$190,249	

EXTRAORDINARY LOSS

The extraordinary loss in 1996, 1995 and 1994 relates to premiums paid to retire certain indebtedness early and the write-off of related deferred financing costs.

EARNINGS PER COMMON SHARE

Primary and fully diluted earnings per common share equals net earnings divided by the weighted average number of common shares outstanding, after giving effect to dilutive stock options. Fully diluted

earnings per common share for 1995 is computed by adjusting both net earnings and shares outstanding as if the September 1995 conversion of the 6⅜% Convertible Junior Subordinated Notes occurred on the first day of the year. The net earnings adjustment in 1995 was $3,590. Fully diluted earnings per common share for 1994 equal net earnings plus after-tax interest incurred on the 8¼% Convertible Junior Subordinated Debentures up to the date of their redemption on October 24, 1994, and on the 6⅜% Convertible Junior Subordinated Notes of $14,805, divided by common shares outstanding after giving effect to dilutive stock options and for shares assumed to be issued on conversion of the Company's convertible securities.

PREFERRED STOCK

The Company has authorized 5,000,000 shares of voting cumulative preferred stock; 2,000,000 were available for issuance at December 28, 1996. The stock has a par value of $100 and is issuable in series.

COMMON STOCK

The Company has authorized 350,000,000 shares of $1 par common stock. The main trading market for the Company's common stock is the New York Stock Exchange, where it is listed under the symbol KR. For the three years ended December 28, 1996, changes in common stock were:

	Issued		In Treasury	
	Shares	Amount	Shares	Amount
January 1, 1994	118,549,173	$ 308,534	10,901,846	$277,244
Exercise of stock options including restricted stock grants	2,023,975	26,473	15,479	376
Sale of treasury shares to the Company's employee benefit plans		(3,495)	(1,341,094)	(34,104)
Tax benefit from exercise of non-qualified stock options		7,056		
December 31, 1994	120,573,148	338,568	9,576,231	243,516
Exercise of stock options including restricted stock grants	2,506,667	40,017	8,120	272
Shares issued on conversion of Convertible Junior Subordinated Notes	10,698,106	196,451	(8,401)	(157)
Tax benefit from exercise of non-qualified stock options		11,505		
December 30, 1995	133,777,921	586,541	9,575,950	243,631
Exercise of stock options including restricted stock grants	2,683,600	50,091	5,906	255
Tax benefit from exercise of non-qualified stock options		21,598		
December 28, 1996	136,461,521	$ 658,230	9,581,856	$243,886

STOCK OPTION PLANS

The Company grants options for common stock to employees under various plans, as well as to its non-employee directors owning a minimum of 1,000 shares of common stock of the Company, at an option price equal to the fair market value of the stock at the date of grant. In addition to cash payments, the plans provide for the exercise of options by exchanging issued shares of stock of the Company. At December 28, 1996 and December 30, 1995, 455,059 and 3,219,730 shares of common stock, respectively, were available

for future options. Options may be granted under the 1987, 1988, 1990 and 1994 plans until 1997, 1998, 2000, and 2004, respectively, and generally will expire 10 years from the date of grant. Options granted prior to May 1994 become exercisable six months from the date of grant. Options granted beginning in May 1994 vest in one year to three years. All grants outstanding become immediately exercisable upon certain changes of control of the Company.

Changes in options outstanding under the stock option plans, excluding restricted stock grants, were:

	Shares Subject To Option	Weighted Average of Exercise Price of Options
Outstanding, January 1, 1994	11,608,359	$15.40
Granted	2,666,175	$23.39
Exercised	(1,878,973)	$13.23
Cancelled or expired	(89,679)	$19.79
Outstanding, December 31, 1994	12,305,882	$17.43
Granted	2,774,650	$25.70
Exercised	(2,339,390)	$16.89
Cancelled or expired	(77,615)	$14.18
Outstanding, December 30, 1995	12,663,527	$19.36
Granted	2,843,510	$41.42
Exercised	(2,669,708)	$18.07
Cancelled or expired	(91,759)	$32.24
Outstanding, December 28, 1996	12,745,570	$24.46

The Company applies Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees," and related interpretations in accounting for its plans. Accordingly, no compensation expense has been recognized for its stock-based compensation plans other than for restricted stock awards. Had compensation cost for the Company's stock option plans been determined based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," the Company's net income and fully diluted net earnings per share would have been reduced by approximately $12,800, or $.09 per share and $5,200, or $.04 per share, for 1996 and 1995, respectively. The weighted average fair value of the options granted during 1996 and 1995 was estimated as $11.77 and $7.91, respectively, on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: volatility of 22.7% and 26.6%, for 1996 and 1995, respectively, risk-free interest rate of 6.3% and 6.4%, for 1996 and 1995 respectively, and an expected term of approximately 3.3 years for both 1996 and 1995. A summary of options outstanding and exercisable at December 28, 1996 follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Options Outstanding at 12/28/96	Weighted-Average Remaining Contractual Life in yrs.	Weighted-Average Exercise Price	Options Exercisable at 12/28/96	Weighted-Average Exercise Price
$ 4.92-$10.00	1,014,958	1.36	$ 7.35	1,014,958	$ 7.35
$10.00-$20.00	3,436,067	4.94	16.17	3,436,067	16.17
$20.00-$30.00	5,490,510	7.14	24.37	3,992,720	24.07
$30.00-$44.50	2,804,035	9.42	41.44	9,700	41.06
	12,745,570			8,453,445	

At December 30, 1995 and December 31, 1994, options for 8,869,223 shares and 9,725,292 shares, respectively, were exercisable at a weighted average exercise price of $17.04 and $15.34, respectively.

In addition to stock options, the Company may grant stock appreciation rights (SARs) under the 1994 plan. In general, the eligible optionees are permitted to surrender the related option and receive shares of the Company's common stock and/or cash having a value equal to the appreciation on the shares subject to the options. The appreciation of SARs is charged to earnings in the current period based upon the market value of common stock. As of December 28, 1996 and December 30, 1995, there were no SARs outstanding.

The Company also may grant limited stock appreciation rights (LSARs) to executive officers in tandem with the related options. LSARs operate in the same manner as SARs but are exercisable only following a change of control of the Company. As of December 28, 1996 and December 30, 1995, there were no LSARs outstanding.

Also, the Company may grant restricted stock awards to eligible employee participants. In general, a restricted stock award entitles an employee to receive a stated number of shares of common stock of the Company subject to forfeiture if the employee fails to remain in the continuous employ of the Company for a stipulated period. The holder of an award is entitled to the rights of a shareowner except that the restricted shares and the related rights to vote or receive dividends may not be transferred. The award is charged to earnings over the period in which the employee performs services and is based upon the market value of common stock at the date of grant for those grants without performance contingencies. As of December 28, 1996 and December 30, 1995, awards related to 178,902 and 209,426 shares, respectively, were outstanding. Of the awards outstanding at December 28, 1996 and December 30, 1995, 100,000 shares are contingent on the attainment of certain performance objectives. The charge to earnings for grants with performance-contingent vesting includes share appreciation between the grant date and the vesting date.

The Company may grant performance units under the 1994 plan, either in conjunction with or independent of a grant of stock options. Performance units entitle a grantee to receive payment in common stock and/or cash based on the extent to which performance goals for the specified period have been satisfied. As of December 28, 1996 and December 30, 1995, there were no performance units outstanding.

Incentive shares may be granted under the 1994 plan, which consist of shares of common stock issued subject to achievement of performance goals. No incentive shares were outstanding as of December 28, 1996 and December 30, 1995.

CONTINGENCIES

The Company continuously evaluates contingencies based upon the best available evidence.

Management believes that allowances for loss have been provided to the extent necessary and that its assessment of contingencies is reasonable. To the extent that resolution of contingencies results in amounts that vary from management's estimates, future earnings will be charged or credited.

The principal contingencies are described below:

Income Taxes—The Company has closed all tax years through 1983 with the Internal Revenue Service. The Internal Revenue Service has completed its examination of the Company's tax returns for tax years 1984–1989. All issues have been resolved with one exception. Efforts to resolve this issue for tax years 1984–1986 with the Appeals Division of the Internal Revenue Service were unsuccessful. As a result the Company filed a petition with the United States Tax Court in Washington, D.C. Litigation was completed in November 1995 and a decision was rendered in January 1997 in favor of the Company. The Company is awaiting a decision from the Internal Revenue Service regarding appeal. This issue for years 1987–1989 is being held in abeyance pending the ultimate outcome of this court case. The Company has provided for this and other tax contingencies.

Insurance—The Company's workers' compensation risks are self-insured in certain states. In addition, other workers' compensation risks and certain levels of insured general liability risks are based on retrospective premium plans, deductible plans, and self-insured retention plans. The liability for workers' compensation risks is accounted for on a present value basis. Actual claim settlements and expenses incident thereto may differ from the provisions for loss. Property risks have been underwritten by a subsidiary and are reinsured with unrelated insurance companies. Operating divisions and subsidiaries have paid premiums, and the insurance subsidiary has provided loss allowances, based upon actuarially determined estimates.

Litigation—The Company is involved in various legal actions arising in the normal course of business. Management is of the opinion that their outcome will not have a material adverse effect on the Company's financial position or results of operations.

WARRANT DIVIDEND PLAN

On February 28, 1986, the Company adopted a warrant dividend plan in which each holder of common stock is entitled to one common stock purchase right for each share of common stock owned. The

Plan was amended and restated as of November 30, 1995. When exercisable, the nonvoting rights entitle the registered holder to purchase one share of common stock at a price of $175 per share. The rights will become exercisable, and separately tradeable, ten days after a person or group acquires 10% or more of the Company's common stock or ten business days following a tender offer or exchange offer resulting in a person or group having beneficial ownership of 10% or more of the Company's common stock. In the event the rights become exercisable and thereafter the Company is acquired in a merger or other business combination, each right will entitle the holder to purchase common stock of the surviving corporation, for the exercise price, having a market value of twice the exercise price of the right. Under certain other circumstances, including the acquisition of 25% or more of the Company's common stock, each right will entitle the holder to receive upon payment of the exercise price, shares of common stock with a market value of two times the exercise price. At the Company's option, the rights, prior to becoming exercisable, are redeemable in their entirety at a price of $.01 per right. The rights are subject to adjustment and expire March 19, 2006.

PENSION PLANS

The Company administers non-contributory defined benefit retirement plans for substantially all non-union employees. Funding for the pension plans is based on a review of the specific requirements and on evaluation of the assets and liabilities of each plan. Employees are eligible to participate upon the attainment of age 21 (25 for participants prior to January 1, 1986) and the completion of one year of service, and benefits are based upon final average salary and years of service. Vesting is based upon years of service.

The Company-administered pension benefit obligations and the assets were valued as of the end of 1996 and 1995. Substantially all plan assets are invested in cash and short-term investments or listed stocks and bonds, including $94,229 and $118,187 of common stock of The Kroger Co. at the end of 1996 and 1995, respectively. The status of the plans at the end of 1996 and 1995 was:

	1996	1995
Actuarial present value of benefit obligations:		
Vested employees	$686,203	$642,582
Non-vested employees	40,837	39,503
Accumulated benefit obligations	727,040	682,085
Additional amounts related to projected salary increases	147,057	134,208
Projected benefit obligations	874,097	816,293
Plan assets at fair value	947,725	878,121
Plan assets in excess of projected benefit obligations	$ 73,628	$ 61,828
Consisting of:		
Unamortized transitional asset	$ 14,456	$ 22,997
Unamortized prior service cost and net gain	40,860	18,617
Adjustment required to recognize minimum liability	13,619	11,266
Prepaid pension cost in Consolidated Balance Sheet	4,693	8,948
	$ 73,628	$ 61,828

The components of net periodic pension expense (income) for 1996, 1995 and 1994 are as follows:

	1996	1995	1994
Service cost	$ 25,977	$ 20,249	$ 18,959
Interest cost	61,090	57,218	47,778
Return on assets	(110,819)	(211,942)	23,935
Net amortization and deferral	28,785	131,360	(103,495)
Net periodic pension expense (income) for the year	$ 5,033	$ (3,115)	$(12,823)
Assumptions:			
Discount rate	7.75%	7.25%	8.5%
Salary Progression rate	4.75%	4.25%	5.5%
Long-term rate of return on plan assets	9.5%	9.5%	9.5%

1996 and 1995 assumptions represent the rates in effect at the end of the fiscal year. These rates were used to calculate the actuarial present value of the benefit obligations at December 28, 1996 and December 30, 1995, respectively. However, for the calculation of periodic pension expense for 1996 and income for 1995 the assumptions in the table above for 1995 and 1994, respectively, were used. The 1997 calculation of periodic pension expense (income) will be based on the assumptions in the table above for 1996.

The Company also administers certain defined contribution plans for eligible union and non-union employees. The cost of these plans for 1996, 1995 and 1994 was $21,278, $24,902 and $24,298, respectively.

The Company participates in various multi-employer plans for substantially all union employees. Benefits are generally based on a fixed amount for each year of service. Contributions and expense for 1996, 1995 and 1994 were $88,758, $90,872 and $87,711, respectively. Information on the actuarial present value of accumulated plan benefits and net assets available for benefits relating to the multi-employer plans is not available.

POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. The majority of the Company's employees may become eligible for these benefits if they reach normal retirement age while employed by the Company. Funding of retiree health care and life insurance benefits occurs as claims or premiums are paid. For 1996, 1995 and 1994, the combined payments for these benefits were $10,634, $10,025 and $10,996, respectively.

The following table sets forth the postretirement benefit plans combined status at December 28, 1996 and December 30, 1995:

	1996	1995
Accumulated postretirement benefit obligation (APBO)		
Retirees	$ 96,262	$100,166
Fully eligible active participants	36,898	36,862
Other active participants	120,012	125,098
	253,172	262,126
Unrecognized net gain	59,762	34,394
Accrued postretirement benefit cost	$312,934	$296,520

The components of net periodic postretirement benefit costs are as follows:

	1996	1995	1994
Service costs (benefits attributed to employee services during the year)	$ 9,557	$ 9,344	$ 9,181
Interest cost on accumulated postretirement benefit obligations	18,006	20,662	19,743
Net amortization and deferral	(991)	(725)	—
	$26,572	$29,281	$28,924

The significant assumptions used in calculating the APBO are as follows:

		Health Care Trend Rate		
	Discount Rate	Initial	Ultimate	Years to Ultimate
Year-end 1994	8.50%	12.3%	4.5%	12
Year-end 1995	7.25%	10.0%	5.0%	7
Year-end 1996	7.75%	9.3%	5.0%	6

The effect of a one percent increase in the medical trend rate is as follows:

	Periodic Cost	APBO
Year-end 1994	$4,088	$27,283
Year-end 1995	$4,037	$32,209
Year-end 1996	$4,114	$23,942

RECENTLY ISSUED ACCOUNTING STANDARDS

In February 1997 the Financial Accounting Standard Board issued Statement of Financial Accounting Standards No. 128, "Earnings Per Share". The Company will implement the statement in the fourth quarter 1997, the effect of which has not yet been determined.

QUARTERLY DATA (UNAUDITED)

	Quarter				Total
1996	First (12 weeks)	Second (12 weeks)	Third (16 weeks)	Fourth (12 weeks)	Year (52 weeks)
Sales	$5,784,254	$5,844,366	$7,343,132	$6,199,157	$25,170,909
Merchandise costs	4,367,967	4,412,202	5,582,032	4,679,264	19,041,465
Extraordinary loss	(1,084)	(766)	(928)	(84)	(2,862)
Net earnings	75,406	77,612	71,420	125,435	349,873
Primary earnings per common share:					
Earnings before extraordinary loss	.59	.60	.55	.95	2.68
Extraordinary loss	(.01)	(.01)	(.01)	0	(.02)
Primary net earnings per common share	.58	.59	.54	.95	2.66
Fully-diluted earnings per common share:					
Earnings before extraordinary loss	.59	.60	.55	.95	2.67
Extraordinary loss	(.01)	(.01)	(.01)	0	(.02)
Fully-diluted net earnings per common share	.58	.59	.54	.95	2.65
1995					
Sales	$5,464,954	$5,652,890	$6,959,216	$5,860,735	$23,937,795
Merchandise costs	4,129,439	4,267,794	5,284,006	4,416,787	18,098,027
Extraordinary loss	(5,336)	(5,451)	(1,516)	(3,750)	(16,053)
Net earnings	59,141	77,012	61,161	105,499	302,813
Primary earnings per common share:					
Earnings before extraordinary loss	.56	.71	.52	.84	2.65
Extraordinary loss	(.05)	(.05)	(.01)	(.03)	(.13)
Primary net earnings per common share	.51	.66	.51	.81	2.52
Fully-diluted earnings per common share:					
Earnings before extraordinary loss	.53	.67	.49	.84	2.50
Extraordinary loss	(.04)	(.04)	(.01)	(.03)	(.12)
Fully-diluted net earnings per common share	.49	.63	.48	.81	2.38

Common Stock Price Range

	1996		1995	
Quarter	High	Low	High	Low
1st	39⅝	33½	27⅞	23⅜
2nd	44	37½	28	25
3rd	45	37⅛	34¾	26½
4th	47½	40¾	37¾	31⅞

The number of shareowners of record of common stock as of March 10, 1997, was 47,128.

Under the Company's Credit Agreement dated July 19, 1994, as amended, the Company is prohibited from paying cash dividends during the term of the Credit Agreement. The Company is permitted to pay dividends in the form of stock of the Company.

SELECTED FINANCIAL DATA

	Fiscal Years Ended				
	December 28, 1996 (52 Weeks)	December 30, 1995 (52 Weeks)	December 31, 1994 (52 Weeks)	January 1, 1994 (52 Weeks)	January 2, 1993 (53 Weeks)
	(In thousands of dollars, except per share amounts)				
Sales from continuing operations	$25,170,909	$23,937,795	$22,959,122	$22,384,301	$22,144,588
Earnings from continuing operations before extraordinary loss and cumulative effect of change in accounting	352,735	318,866	268,903	170,805	101,160
Extraordinary loss (net of income tax credit)(A)	(2,862)	(16,053)	(26,707)	(23,832)	(107,103)
Cumulative effect of change in accounting (net of income tax credit)(B)				(159,193)	
Net earnings (loss)	349,873	302,813	242,196	(12,220)	(5,943)
Fully diluted earnings (loss) per share					
Earnings from continuing operations before extraordinary loss	2.67	2.50	2.19	1.50	1.11
Extraordinary loss(A)	(.02)	(.12)	(.21)	(.19)	(1.17)
Cumulative effect of change in accounting(B)				(1.28)	
Net earnings (loss)	2.65	2.38	1.98	.03	(.06)
Total assets	5,825,413	5,044,717	4,707,674	4,480,464	4,303,084
Long-term obligations, including obligations under capital leases	3,659,491	3,489,728	3,889,194	4,135,013	4,472,978
Shareowners' deficit	(1,181,706)	(1,603,013)	(2,153,684)	(2,459,642)	(2,700,044)
Cash dividends per common share	(C)	(C)	(C)	(C)	(C)

(A) See Extraordinary Loss in the Notes to Consolidated Financial Statements.

(B) See Postretirement Health Care and Life Insurance Benefits in the respective year's Notes to Consolidated Financial Statements.

(C) The Company is prohibited from paying cash dividends under the terms of its Credit Agreement.

EXECUTIVE OFFICERS

Warren F. Bryant
President and Chief Executive Officer—
Dillon Companies, Inc.

David B. Dillon
President and Chief
Operating Officer

Paul W. Heldman
Vice President, Secretary and
General Counsel

Michael S. Heschel
Executive Vice President and
Chief Information Officer

Patrick J. Kenney
Executive Vice President

W. Rodney McMullen
Group Vice President and
Chief Financial Officer

Thomas E. Murphy
Group Vice President

Jack W. Partridge, Jr.
Group Vice President

Joseph A. Pichler
Chairman of the Board and
Chief Executive Officer

Ronald R. Rice
President—Manufacturing,
Senior Vice President

James R. Thorne
Senior Vice President

Lawrence M. Turner
Vice President and Treasurer

The Company has a variety of plans designed to allow employees to acquire stock in Kroger. Employees of Kroger and its subsidiaries own shares through a profit sharing plan, as well as 401(k) plans and a payroll deduction plan called the Kroger Stock Exchange. If employees have questions concerning their shares in the Kroger Stock Exchange, or if they wish to sell shares they have purchased through this plan, they should contact:

Star Bank, N.A. Cincinnati
P.O. Box 5277
Cincinnati, Ohio 45201
Toll Free 1-800-872-3307

Questions regarding the Company's 401(k) plan should be directed to the employee's Human Resources Manager or 1-800-2KROGER.

Questions concerning any of the other plans should be directed to the employee's local Human Resources Manager.

SHAREOWNERS: The Bank of New York is Registrar and Transfer Agent for the Company's Common Stock.
For questions concerning changes of address, etc., individual shareowners should contact:

Written inquiries:
The Bank of New York
Investor Relations Department
P.O. Box 11258
Church Street Station
New York, New York 10286

Certificate transfer and address changes:
The Bank of New York
Receive and Deliver Department
P.O. Box 11002
Church Street Station
New York, New York 10286

The Bank's toll-free number is: 1-800-524-4458.

SHAREOWNER UPDATES: The Kroger Co. provides a pre-recorded overview of the Company's most recent quarter. Call 1-800-4STOCKX or, in Cincinnati, 762-4723.

FINANCIAL INFORMATION: Call (513) 762-1220 to request printed financial information, including the Company's most recent report on Form 10-Q or 10-K, or press release. Written inquiries should be addressed to Shareholder Relations, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45202-1100. Financial information also is available on the Internet at www.cfonews.com/kr.